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# Supreme Court of the United States

**October Term, 1961**

**No. [redacted]**

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

*Petitioners,*

*against*

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

*Respondents.*

*In the Matter*
*of*
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

*Debtor.*

## PETITION FOR WRITS OF CERTIORARI to the United States Court of Appeals for the Second Circuit

**In Proceedings for the Reorganization of a Corporation**
**TWO CASES (No. 26362 and No. 27000)**

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# Supreme Court of the United States

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*Petitioners,*

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## PETITION FOR WRITS OF CERTIORARI to the United States Court of Appeals for the Second Circuit

**In Proceedings for the Reorganization of a Corporation**
**TWO CASES (No. 26362 and No. 27000)**

Petitioners Irving J. Wolf, Robert H. Davidson, Richard S. Hull, and Frederick Katzenell pray that Writs of Certiorari issue to review the judgments of the United States

Court of Appeals for the Second Circuit, entered in the above companion cases, Docket No. 26362 and Docket No. 27000, on November 9, 1961.[1]

## Opinions Below

In No. 26362, the District Court for the Southern District of New York (*per* SUGARMAN, *D. J.*) rendered a memorandum opinion on January 4, 1960 (R vol. III, 7a) and an opinion from the bench on June 14, 1960 (R vol. III, 1a-20a), and made findings of fact and conclusions of law, dated November 7, 1960, and filed November 23, 1960 (R vol. III, 21a-30a); they are not reported. In No. 27000, said District Court made findings of fact and conclusions of law, dated and filed October 19, 1960 (R 3a-18a); they are not reported, and there is no opinion. The opinions of the Court of Appeals for the Second Circuit (*before* MOORE, FRIENDLY, and SMITH, *Cir. JJ.*) in No. 26362 (*per* FRIENDLY, *Cir. J.*) (R vol. IV, 18a-31a) and in No. 27000 (*per* MOORE, *Cir. J.*) (R24a-39a) are reported at 296 F. 2d 678 and 296 F. 2d 670 (respectively).

## Jurisdiction

The judgments of the Court of Appeals for the Second Circuit were made and entered on November 9, 1961 (No. 26362: R vol. IV, 32a; No. 27000: R 40a). Petitions for rehearing of both cases were filed by Petitioners on November 21, 1961 (No. 26362: R vol. IV, 34a; No. 27000: R 42a), and were denied without further opinion on November 29, 1961 (No. 26362: R vol. IV, 40a; No. 27000: R 59a). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

---

[1] Arnold A. Weinstein, Jerome Fried, and Nazareth Fair Grounds & Farmers' Market, Inc. (the Debtor in posession, a nominal party) are Respondents in both No. 26362 and No. 27000. An additional Respondent in No. 26362 is Nazareth Enterprises, Inc. Additional Respondents in No. 27000 are all the beneficial owners of stock-claims besides the named Petitioners and Respondents. Petitioners do *not* seek review of a third companion case, No. 26962 (*see App. A*).

## Questions Presented

### No. 26362

1. A Chapter X court has been petitioned to *remove* fiduciaries from office on the grounds of their personal trading in the debtor's stock *during* the reorganization proceedings and their diversions of the debtor's rents to themselves *during* the proceedings, and (on the same grounds) to deny them *compensation* out of the estate for services rendered by them *during* the proceedings. By statute, and as an equity receivership court, the Chapter X court has exclusive jurisdiction over the continued service of *all* fiduciaries and over the "reasonableness" of *all* compensation paid to *all* fiduciaries. In exercising that jurisdiction, is there a *double standard* which (a) requires the court to apply a strict *federal* standard of fiduciary conduct to those fiduciaries *alone* who were "disinterested" at the *commencement* of the proceedings, (b) yet permits the court to apply a different, looser *state* standard of fiduciary conduct to those fiduciaries who serve *during* the proceedings, but who were *not* "disinterested" at the *commencement* of the proceedings?

2. Does the payment of compensation to the officers of a Chapter X debtor in possession *week-by-week during* the proceedings, *exempt* such officers from the mandate and bar of § 249—that "No compensation or reimbursement shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold * * * stock [of the debtor] * * *."—although payment of compensation to such officers *in gross at the winding-up* of the proceedings, would be absolutely barred by § 249?

### No. 27000

3. In a Chapter X reorganization proceeding, in adjudicating *claims* to stock interests in the debtor, which interests vested under state law prior to commencement of the

reorganization proceedings, and where no supervening federal statute or policy exists: Is the federal court (having *non-diversity* jurisdiction) required to apply *state rules of decision in equity?* If so, does the application of such state rules of decision extend to *remedies* as well as rights?

## Statement of the Case

The Debtor was incorporated in Pennsylvania on August 7, 1951, to operate a "farmers' market". Its sole assets are land and buildings at a highway junction in Nazareth, Pennsylvania. It rents space inside the buildings to merchants, and an outside race-track for stock-car racing. Its sole earnings are those rents.

The Debtor was organized by the "Philadelphia Group", a joint venture which had acquired the realty on April 17, 1951, and conveyed it to the Debtor on September 26, 1951, at their cost. The Debtor paid the Philadelphia Group part of the price by an original issue of 20 shares (of nominal book value, and the only outstanding stock until February of 1953). On October 17, 1951, the Philadelphia Group sold their entire interest (including the 20 shares) to John Malakoff, at a profit. From April of 1951, when he had bought a ¼ interest in the venture, to 1952, Malakoff personally paid the Philadelphia Group, in irregular installments, most of the purchase price of the realty and the stock; eventually, they forgave him the balance due.

Malakoff undertook a clumsy real estate "syndication" or promotion. Between April of 1951 and April of 1953, he sold "shares" in the Market to at least 41 persons. Every purchaser paid Malakoff personally (some by cash; some by check, some by credit against Malakoff's debts); he received substantially more from those purchasers than he paid the Philadelphia Group. In turn, Malakoff paid "dividends" to the purchasers, in regular monthly installments out of his own bank accounts, mostly computed at 20% per year on their original advances to him. Virtually all the transac-

tions occurred in New York, where Malakoff and most of the purchasers resided. The prices and other terms varied radically over the two-year period. Generally, the "shares" were described as $n/200$ of the Market; most were sold for $1,000 per "share". Until the delivery of the stock certificates early in 1953, most of the purchasers held only letter-receipts from Malakoff as evidence of their payments and other terms of their transactions with him. Of the several forms used, the most common—drafted by respondent Weinstein, as Malakoff's lawyer—was the following:

> "You understand, of course, that *all of the authorized stock* of The Nazareth Farmers and Auction Market Inc. [*sic*] which owns the Market *has been issued to me.* * * *
>
> "In the course of my management of the Market, I may cause to be issued to you shares *of my present stockholdings.* In the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your shares will be applied as your contribution with a corresponding proportionate interest. * * *
>
> "It is contemplated that the construction, performance, and execution of our understanding shall be governed by the Laws of the State of New York." (R13442; emphasis supplied.)

Not later than June of 1952, Malakoff took control of the Debtor. He became its president and a director; his employee, respondent Fried, became secretary-treasurer, a director, and general manager. In August of 1952, Fried (acting for the Debtor as landlord) leased the race-track to Fried's then-partner for ten years; in April of 1953, Fried's corporation (Nazareth Enterprises, Inc.) took over the lease as tenant.

By early 1953, Malakoff was in financial trouble. Between February and April, he caused the Debtor to issue

and deliver stock certificates (co-signed by Malakoff and Fried) to evidence the "shares" Malakoff had sold. The Debtor's charter authorized the issuance of 200 shares, and Malakoff had represented the "share" total as 200; in fact, he oversold, and he caused the issuance of at least 316 shares.

By May of 1953, Malakoff's "dividend" checks had stopped. The stockholders, previously dormant, then interceded. In June, Malakoff surrendered his own stock (the original 20 shares) to the Debtor, and Malakoff and Fried resigned as officers and directors. At a stockholders' meeting on June 29, 1953, Weinstein was elected president and a director. He continued Fried's service as general manager.

The Debtor was and is solvent in the bankruptcy sense. The major problem was to determine the ownership of the Debtor's stock. In effect, in order to resolve that problem, the Debtor selected the Chapter X court as a convenient forum with sweeping jurisdiction over all 41 parties and the subject matter.

On September 28, 1953, on a voluntary petition verified by Weinstein as president, the Debtor entered Chapter X reorganization proceedings in the Southern District of New York. The *ex parte* orders signed that day continued the Debtor in possession, provided that the Debtor "by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of" the Debtor, and authorized payment of a weekly salary to Fried as general manager (R10660, 10663, 10807-11). Later orders increased Fried's salary, and authorized a weekly salary to Weinstein, too.

**No. 27000**

In 1955 and 1956, the District Court issued "bar orders" [2] which compelled all the stockholders to file proofs of claim to stock interests in the Debtor (R13492). The Debtor's

[2] *See* Bankruptcy Act, § 196; 11 U. S. C. § 596; 52 Stat. 893 (1938); *see also*, 6 Collier on Bankruptcy (14th ed.) ¶¶ 9.03, 9.04.

answers (verified by Weinstein as president) objected to the allowance of every single stock-claim and asked cancellation of all the stock; alternatively, the Debtor counterclaimed for the subscription price of any stock which might be validated. (Malakoff had died, insolvent, in 1955; he was never a party to the proceedings.) After 86 trial days in 1958 and 1959, and a 10,000-page record on the 36 stock-claims involved in No. 27000, the District Court, by order dated December 8, 1960, allowed *all* the stock-claimants to participate in the estate, according to the "net fair value" of their respective "investments" (*i.e.*, their advances to Malakoff, less "dividends" received). The Debtor's counterclaims for the stock subscription price were denied (R3a-23a).

Three appeals were taken, by Petitioners and by Weinstein and Fried (each acting individually). The Debtor did not appeal; however, on Weinstein's authorization, the Debtor, as appellee, attacked the District Court's allowance of 10 of the 36 claims involved in No. 27000, including the four claims involved in the Weinstein-Fried appeals. Neither the Debtor nor any other party appealed from the denial of the Debtor's counterclaims for the stock subscription prices (by contrast to the allowances and awards to the stock-claimants).

On November 9, 1961, the Court of Appeals reversed, and effectually adopted the rationale of Weinstein and Fried. The Court of Appeals set up two classes of stock-claimants. Five stock-claims, and most of a sixth, were disallowed; that stock was cancelled. The other 30 stock-claims were allowed according to the respective sums advanced to Malakoff, but without deduction of "dividends".

In sum, both the District Court and the Court of Appeals, purporting to apply Pennsylvania corporation law, held *all* the Debtor's outstanding stock absolutely void for lack of consideration to the Debtor. Then, on general principles of "equity", without further reference to state law, and as though there were no corporation, both courts undertook to distribute the assets of the Debtor anew. Shares of stock

were to be issued proportionate to the prevailing stock-claimants' equitable "interests" in the Debtor's assets. Free of any applicable *law*, the courts below differed substantially in their respective views of the facts and the "equities".

**No. 26362**

*During* the reorganization proceedings, Weinstein and Fried engaged in two courses of conduct which became the subject of the petitions in No. 26362. Here, unlike No. 27000, the material facts are undisputed.

1. Weinstein and Fried, for their own accounts and for others, bought and sold the Debtor's stock. *E.g.*: (a) In May of 1957, Weinstein, acting for his sister, bought six shares, originally purchased from Malakoff as 3.0% of the total (200) shares, and equal to 4.11% under the decision below. (*See* R vol. III, 31a-32a.) (b) In January of 1958, Weinstein bought ⅔ of one share for himself, originally purchased from Malakoff as 0.33%, and equal to 0.46% under the decision below. (c) In March of 1959, Weinstein, acting for Fried, bought 8 shares, originally purchased from Malakoff as 4.0%, and equal to 5.48% under the decision below.

2. Not later than 1955, Weinstein and Fried agreed: (a) that the percentage rent payable by Fried's race-track corporation to the Debtor on the race-track gross receipts (under the lease made by Fried in 1952), be reduced from 12% or 15% to 10% and 7%; and (b) that the rents theretofore paid by a food concessionaire to the Debtor, thereafter be retained by Fried's corporation. No disclosure was made to the court until 1959. (R vol. III, 32a-48a.)

Having been stockholders, directors, and officers of the Debtor, Weinstein and Fried were not "disinterested" at the commencement of the proceedings.[3]

On June 14, 1960, the District Court terminated the compensation of Weinstein and Fried for trading in the Debtor's stock (under § 249 alone), and effectually removed them from

[3] Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 888 (1938).

office as president and general manager (respectively). No decision was then made as to the race-track rent diversions. On June 28, 1961, the District Court finally decided a related but severed petition involving the race-track rents, and held that Fried owed the Debtor back-rents exceeding $22,000 (R vol. IV, 1a); cross-appeals from that decison are now pending. On July 12, 1960, the Court of Appeals had stayed the removal of Weinstein and Fried from office pending appeal. On November 9, 1961, the Court of Appeals reversed the District Court both as to the removal of Weinstein and Fried from office and as to the termination of their compensation. The Court of Appeals held § 249 inapplicable, as a matter of law, and found no breach of trust by Weinstein or Fried in their trading in the Debtor's stock during the proceedings, as a matter of law. Though omitting even to mention the race-track rent diversions (the alternative grounds of the petitions for removal from office and denial of compensation), and refusing to remand, the Court of Appeals likewise found no breach of trust by Weinstein or Fried in their rent diversions. (*See* R vol. IV, 34a).

## Reasons for Granting the Writ

### No. 26362

In No. 26362, for the first time, a Court of Appeals—the bellwether Second Circuit—has broken with the consistent line of decisions in every Circuit where § 249 of Chapter X has been presented since its enactment in 1938. The questions involving § 249 have never been ruled on by this Court.

In addition, the Second Circuit Court of Appeals has decided questions involving § 221(4) of Chapter X in a way in conflict with applicable decisions of this Court.[4]

The questions of federal reorganization legislation and equity practice presented in No. 26362 are important and

[4] Woods v. City National Bank & Trust Co., 312 U. S. 262 (1941, per Douglas, J.); *see also*, American Mutual Life Insurance Co. v. City of Avon Park, 311 U. S. 138 (1940, per Douglas, J.)

should be settled by this Court. The decision below is in error and should be reversed.

No. 26362 relates to the administration of estates in the custody of the federal courts during Chapter X bankruptcy reorganization proceedings. The paramount principles are: (a) the prohibition of insider trading in the debtor's securities during the proceedings, as a Congressional and judicial *end* and policy, *per se;* and (b) the denial of compensation from the estate to insiders who trade despite the prohibition, as the *means* of effectuating that policy and attaining that end. The decison below confounds that policy, and clouds a hitherto clear *caveat* to insiders.

The crucial statutes are § 249 [5] and § 221(4),[6] enacted in 1938:

> "§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, * * *."

> "§ 221. The judge shall confirm a plan if satisfied that— * * *
>
> "(4) all payments made or promised by the debtor * * *, for services * * * in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable * * *; * * *."

Chapter X's predecessor, § 77B, enacted in 1934, contained no explicit provision comparable to § 249.[7] Section 77B(f)(5) was expanded and became § 221(4) of Chapter X.[8]

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[5] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

[6] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938).

[7] *See* 6 Collier on Bankruptcy (14th ed.) ¶¶ 13.01, 13.18.

[8] *See ibid.*, ¶¶ 11.01, 11.09; Bankruptcy Act, § 77B(f)(5); 11 U. S. C. § 207(f)(5); 48 Stat. 919 (1934) [*Repealed*].

Before 1934, reorganizations had been effected in equity receiverships, and were infamous for insiders' abuse of the judicial process to reap windfalls for themselves by using confidential information in buying and selling the debtor's securities for their own accounts during the proceedings. Virtually all control over compensation and expenses had been left by the courts in the hands of private parties, especially old management and the "protective committees."[9] One of the major innovations of § 77B in 1934 was judicial control over compensation and expenses,[10] under § 77B(c).[11]

Under § 77B, two reorganizations in the Southern District of New York presented situations where committee members, applying to the reorganization courts for allowances of compensation, were found to have traded in securities of the debtor during the proceedings—and therefore were denied all compensation: *Paramount-Publix*[12] and *Republic Gas*.[13] In *Paramount-Publix*, in 1935, Judge Coxe invoked the phrase "reasonable compensation" in § 77B(c) and § 77B(f)(5) as statutory authority for applying principles of equity:

> "The statute [§ 77B(c)(9)] permits the payment of *reasonable compensation* to committee members 'for services rendered.' *This necessarily implies loyal and disinterested service* in the interest of the persons for whom the committee assumes to act, and a committee member who, during his period of service, purchases and sells, or purchases, for personal gain, securities of the company which he is engaged in trying to reorganize, is not entitled to an allowance for his

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[9] *See* 6 Collier on Bankruptcy (14th ed.) ¶ 0.04.

[10] *See ibid.*, ¶¶ 0.04, 0.05.

[11] Bankruptcy Act, § 77B(c); 11 U. S. C. § 207(c); 48 Stat. 915 (1934). [*Repealed.*]

[12] *In re* Paramount-Publix Corp., 12 F. Supp. 823 (S. D. N. Y., 1935, per Coxe, J.).

[13] *In re* Republic Gas Corp., 35 F. Supp. 300 (S. D. N. Y., 1936, per Caffey, J.).

> services as a committee member." 12 F. S. at 828 (emphasis supplied).

A year later, in *Republic Gas*, Judge Caffey quoted Judge Coxe's opinion in *Paramount-Publix*, and followed Judge Coxe's reasoning and decision.

In 1938, the Chandler Act replaced § 77B with Chapter X. Many provisions of § 77B were carried over into Chapter X, and clarified. *Expansion* of § 77B was intended. The new format of Chapter X was stated explicitly, by statute, *not* to restrict the substantive application of any sections of Chapter X;

> "b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate." [14]

Thus, notwithstanding the decision below, it is quite arbitrary to define the "context" of § 249 as less than all of Chapter X. (*Cf. App.* 54a.)

A major purpose of the new reorganization legislation in 1938 was to prevent *all* fiduciaries from *any* traffic in the securities of the debtor they were engaged in operating and reorganizing during the proceedings. Provision for recouping insider profits was carried over from § 77B(b) to § 212 of Chapter X;[15] for both reorganization legislation and securities regulation enacted by Congress in the 1930s were in the same context, subject to the same influences, and largely directed to the same objectives.[16] But, *in addition* to § 212, the Chandler Act enacted § 249; that is, *in addition* to restitution of insider profits, Congress prohibited compensation to insiders who traded during the proceedings—

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[14] Additional Provisions of the Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840), § 5b; 11 U. S. C. § 1, notes. *See* Report No. 1916 of Senate Judiciary Committee on H. R. 8046 (1938); 6 Collier on Bankruptcy (14th ed.) ¶¶ 13.02, 13.16.

[15] Bankruptcy Act § 212; 11 U. S. C. § 612; 52 Stat. 895 (1938). *See* 6 Collier on Bankruptcy (14th ed.) ¶ 9.31.

[16] *See, e.g.*, Report of Percival E. Jackson, Counsel to Special Committee of U. S. Senate to Investigate Bankruptcy and Receivership Proceedings, etc. (April 15, 1936), at pp. 51-3, 87; 2 Loss, Securities Regulation (2d ed., 1961), at pp. 719-720, 1124-6.

irrespective of profits. The two sections—§ 212 and § 249—are cumulative, not exclusive.[17]

The legislative history and purpose of § 249 may be seen, for example, in a statement to the House Judiciary Committee in 1937, made by William O. Douglas, a principal draftsman of Chapter X, and then a commissioner of the S. E. C., in explanation and support of § 249:

> "The Chandler bill makes further significant changes in that respect. On page 65 there is a very important provision, that those who have purchased or sold securities in contemplation of or after commencement of the proceedings should not be allowed compensation or reimbursement from the estate. Now, this is a development of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law. * * *
>
> "Now, Judge Coxe up in New York in the *Paramount* case, and Judge Caffey in the *Republic Gas* case, the opinions which were handed down in 1935 and 1936, respectively, disallowed compensation to committee members who purchased or sold securities. Now, this provision on page 65, is a step toward the codification of that rule, an attempt to make it more uniform.
>
> "Mr. Celler: Due to their position they trade in the securities and gain a tremendous advantage?

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[17] *See* 6 Collier on Bankruptcy (14th ed.) ¶ 9.31. In the following Chapter X cases, *both* § 212 and § 249 were applied as remedies for insider trading: Young v. Potts, 161 F. 2d 597 (6th Cir., 1947, *per* Simons, J.), *on remand from* Young v. Higbee Co., 324 U. S. 204 (1945, per Black, J.); *In re* Philadelphia & Western Ry. Co., 64 F. S. 738 (E. D. Pa., 1946, per Kirkpatrick, J.); *In re* Los Angeles Lumber Products Co., Ltd., 37 F. S. 708; 46 F. S. 77 (S. D. Cal., 1941, per Jenney, J.).

> "Mr. Douglas: Yes; by using inside information. * * * so we decided that the best practical way of doing it was to broaden the base a little bit and establish a rule of thumb and follow the pattern of the *Paramount* case and the *Republic Gas* case." [18]

Since § 249 became law in 1938, this Court has never reviewed a § 249 case. However, this Court has stated:

> "* * * In all cases persons who seek compensation for services or reimbursement for expenses are held to fiduciary standards. § 249, * * *; Woods v. City Nat. Bank & T. Co. [citation]. * * *" [20]

In any event, no need for this Court to review a § 249 case had arisen—until now. For invariably, *all* fiduciaries who traded for their own accounts during Chapter X proceedings, were held subject to § 249. Motivation, ignorance, inadvertence, gain or loss: invariably, all were held irrelevant. The Courts of Appeals rigorously applied § 249 in accordance with its legislative history and purpose, from the first appellate decision in 1940—

> "* * * It is doubtless true that the statute, thus construed, may work a hardship in some cases—as in this; but such sporadic cases are inconsiderable compared to the large object sought to be achieved by the law, which is to fix a standard of conduct by persons acting in fiduciary capacities, in these cases, so high as to prevent any possible clash between selfish interest and faithful performance of duty." [21]

—to the last, in 1959—

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[18] Hearings before House Judiciary Committee on H. R. 6439, 75th Cong., 1st Sess. (1937), at pp. 183-4.

[20] Brown v. Gerdes, 321 U. S. 178, *at* 182 (1944, *per* Douglas, J.).

[21] Otis & Co. v. Insurance Bldg. Corp., 110 F. 2d 333, at 335 (1st Cir., 1940, per Peters, D. J.).

> "• • • But in § 249 of the Bankruptcy Act Congress clearly intended drastic results and thought them necessary to eliminate the serious abuses of insider information which had long been existent in equity reorganizations. [Citation.] In the past excuses of inadvertence or *de minimis* have not been permitted to undermine the section, and we do not feel we can narrowly constrict it here. [Cases cited.]" [22]

While this Court has not ruled on § 249, this Court has, since 1938, ruled on numerous reorganization cases involving compensation to fiduciaries. Repeatedly, this Court has held that the Chapter X courts must control the acquisition and distribution of *all* assets of the estate,[23] and that the Chapter X courts have and must exercise *exclusive* jurisdiction and control over *all* compensation which, directly or indirectly, is paid out of the estate and which thus affects the ultimate distribution of assets in judicial custody.[24]

> "Hence Congress instituted controls, controls which became more pervasive as § 77B was evolved into Chapter X. • • •. And § 221(4) is written in pervasive terms—it applies to 'all payments' for services 'in connection with' the proceeding or 'in connection with' the plan and 'incident to' the reorganization, whoever pays them. • • •" [25]

> "These practical considerations support the literal reading of § 221(4) that it is the bankruptcy court that has jurisdiction to pass on these fees. Its jurisdiction is therefore exclusive. • • •" [26]

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[22] Surface Transit, Inc. v. Saxe, Bacon & O'Shea, *266* F. 2d 862, *at* 868 (2d Cir., 1959, *per* Clark, C. J.), *cert. den.* 361 U. S. 862 (1959).

[23] *E.g.*, U. S. v. Knight, 336 U. S. 505 (1949, per Douglas, J.).

[24] Brown v. Gerdes, *supra*, note 20; Leiman v. Guttman, 336 U. S. 1 (1949, per Douglas, J.); *see* Austrian v. Williams, 216 F. 2d 278 (2d Cir., 1954, per Harlan, J.), *cert. den.* [*sub nom.* Fogarty v. Austrian] 348 U. S. 953 (1955).

[25] Leiman v. Guttman, *supra*, note 24, 336 U. S. at 7-8.

[26] *Id.*, 336 U. S. at 9.

By statute, the Chapter X courts have retained all the powers of an equity receivership court.[27] Moreover, even where § 249 does not apply—that is, in Chapter X proceedings, where conflicts of interest exist other than trading in the debtor's securities—this Court has likewise denied compensation to the faithless fiduciaries. Statutory authority is given by § 221(4), a "scrutiny clause" which was carried over into Chapter X from § 77B(f)(5). The same statutory language—"reasonable compensation"—is used in § 221(4) as was used in § 77B(c) and § 77B(f)(5), the sections which were the statutory authority for *Paramount-Publix* and *Republic Gas;* and *Paramount-Publix* has been quoted and followed by this Court in applying the "scrutiny clause" of § 221(4) to deny compensation to Chapter X fiduciaries who had conflicts of interest during the proceedings.

> "Under chap. X of the Chandler Act the bankruptcy court has plenary power to review all fees and expenses in connection with the reorganization from whatever source they may be payable. [Footnote, quoting § 221(4).] Reasonable compensation may be allowed. * * * Furthermore, 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act. * * * It is no answer to say that fraud or unfairness were not shown to have resulted. * * * Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." [28]

* * *

Despite the foregoing history and law, the Court of Appeals held both § 249 and the strict federal standard of the *Woods* case inapplicable to Weinstein and Fried. Now a

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[27] Bankruptcy Act, § 115; 11 U. S. C. § 515; 52 Stat. 884 (1938).

[28] Woods v. City National Bank & Trust Co., *supra,* note 4, 312 U. S. at 267-8; *see* American Mutual Life Insurance Co. v. City of Avon Park, *supra,* note 4, 311 U. S. at 147.

double standard was posited. The fiduciary conduct of Weinstein and Fried was to be judged by a looser state standard, because they had been appointed and compensated "consensually". Under that looser standard, their trading in the Debtor's stock and their diverting its rents were not in breach of trust.

The following words are the crux of Judge Friendly's opinion in No. 26362:

> "* * * Not being required to seek compensation under § 247, they have not been subjected to § 249, and the order of removal cannot survive the fall of its underpinning. [Footnote 5]" (*App.* 55a.)

> "* * * For these strangers the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from *consensual arrangements*, subject only, in the case of officers, to judicial approval under § 191. * * *" (*App.* 55a; emphasis supplied.)

> "* * * Chapter X clearly distinguishes between *what is demanded* of a trustee and *what is expected* of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee * * *) must be *'disinterested,'* * * *. No such requirement was or practically could be imposed on officers of the debtor; * * *." (*App.* 56a; emphasis supplied.)

> "* * * Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees complain; * * *." (*App.* 58a.)

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[29] Bankruptcy Act, § 156; 11 U. S. C. § 556; 52 Stat. 888 (1938).
[30] Bankruptcy Act, § 157; 11 U. S. C. § 557; 52 Stat. 888 (1938).
[31] Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 890 (1938).

1. Under Chapter X, *only* the trustee,[29] the trustee's attorney,[30] and the examiner[31] are required to be "disinterested."[32] It is not alone the officers and employees of a debtor in possession who need not be "disinterested." Likewise, virtually every other person serving in the proceedings, and looking to the estate for compensation, need not be "disinterested"; *e.g.*, the "additional trustee,"[33] attorneys employed on specific retainers,[34] indenture trustees, committee members. Except the trustee, the additional trustee, the trustee's attorney, and the examiner, all those persons are appointed by "consensual arrangements" with their clients —but all appointments remain subject to judicial approval.[35] As likely as not, those persons (*e.g.*, indenture trustees) will have served before as well as during the proceedings. Their compensation may have been fixed by contract with the clients or classes they represent; the contracts may have been executed either before or during reorganization; and they may be paid by their clients out of court, not by the trustee's disbursement.[36] Nevertheless, under § 221(4), the Chapter X court *must* review the "reasonableness" of their compensation.[37] But under the interpretation below, "reasonableness" no longer "necessarily implies loyal and disinterested service."

2. At once, there is a new order when a Chapter X petition is filed: federal law supervenes; the federal judge, above the stockholders, above the state legislature, is master; the debtor's officers are his servants. Some officers the judge newly appoints; some continue in service at executive level with his approval. The latter are compensated by regular salaries, instead of in gross at the winding-up.[38] Now, says

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[32] Bankruptcy Act, § 158; 11 U. S. C. § 558; 52 Stat. 888 (1938).
[33] Bankruptcy Act, § 156, *supra*, note 29.
[34] Bankruptcy Act, § 157, *supra*, note 30.
[35] Bankruptcy Act, § 212, *supra*, note 14; § 157, *supra*, note 30; § 191, 11 U. S. C. § 591, 52 Stat. 893 (1938).
[36] *See, e.g.*, Leiman v. Guttman, *supra*, note 24.
[37] Bankruptcy Act, § 221(4), *supra*, note 6; *see* cases cited in note 24, *supra*.
[38] Bankruptcy Act, § 191, *supra*, note 35.

the Court of Appeals, the correlate of that *privilege* of continued service and regular salary (without "disinterestedness") would be, not a responsibility, but a license to trade in the debtor's securities during the proceedings, as before. Their trading would still be no breach of trust, absent proof of actual over-reaching and actual profit; even then, the remedy would be limited to restitution of their profits. In short, fiduciaries not required to *be* "disinterested" at the *commencement* of the Chapter X proceedings, would *also not* be required to *act* in a disinterested manner *during* the Chapter X proceedings. For them, Chapter X would bring no change. The strict federal standard would apply only to the few "disinterested" at commencement, while the loose non-federal standard would apply to the many not "disinterested"— though *all* had "assumed *to act in the proceedings* in a fiduciary capacity."

3. The Court of Appeals would disregard the *functions* of key operating personnel, their access to confidential information, and their actual control of the debtor being reorganized. Not their powers and acts, but their titles, would define their responsibilities—despite the lucid functional definitions of the Bankruptcy Act [39] and the equity courts.[40] Form, not substance, would govern.

4. The decision below does not merely chip at § 249. It cleaves the statute and emasculates judicial control of compensation in Chapter X proceedings, thereby thwarting the Congressional and judicial purpose of preventing and penalizing insider trading. For the license to trade given by that decision would extend, not only to officers of a debtor in possession in a small case, but to all key operating personnel employed by a trustee or a debtor, in any case, big or small.

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[39] Bankruptcy Act, §§ 1(22), 1(23); 11 U. S. C. §§ 1(22), 1(23); 52 Stat. 840 (1938) ("officer" and "person", respectively). *See* Bankruptcy Act, § 188; 11 U. S. C. § 588; 52 Stat. 892 (1938).

[40] *See, e.g., In re* Frazin & Oppenheim, 181 Fed. 307, at 309 (2d Cir., 1910, per Noyes, J.).

Moreover, the refusal to apply § 249 or § 221(4) or non-statutory principles of equity in Chapter X proceedings, would be precedent for like refusal in railroad reorganizations under § 77,[41] in S.E.C. public utility reorganizations,[42] and in other reorganization proceedings under the Bankruptcy Act,[43] where the applicable statutes all contain language similar to the language of § 249 or § 221(4).

5. The double standard posited by the Court of Appeals is utterly inconsistent with the single and absolute standard which should be exacted of all fiduciaries in Chapter X proceedings, regardless of their mode of compensation and their mode of appointment. It is the *source of compensation* —the estate in judicial custody—which gives the Chapter X court exclusive jurisdiction over compensation *and* which should impose a single standard of conduct and compensation for all Chapter X fiduciaries.

By statute, the Chapter X judge must approve all appointments and must approve all compensation. The jurisdiction over compensation is exclusive. Unless that exclusive jurisdiction over compensation carries with it the substantive fiduciary standards set by § 249 and § 221(4), the jurisdiction is hollow.

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[41] *See* R. F. C. v. Bankers Trust Co., 318 U. S. 163 (1943, *per* Roberts, J.; Douglas, J., *concurring*); *see also*, 5 Collier on Bankruptcy (14th ed.) ¶ 77.28.

[42] *See* S. E. C. v. Dumaine, 218 F. 2d 308 (1st Cir., 1954, *per* Woodbury, J.) *cert. den.* 349 U. S. 929 (1955); *and see* 2 Loss, Securities Regulation (2d ed., 1961), at pp. 1127-9.

[43] *E.g.*, Ch. IX; *see* American Mutual Life Insurance Co. v. City of Avon Park, *supra*, note 4; *and see* 5 Collier on Bankruptcy (14th ed.) ¶ 81.23.

## No. 27000

No. 27000 relates to the allowance and disallowance of claims to stock interests in the Debtor. The Court of Appeals has cancelled and reduced a large proportion of the shares of stock of record. Important questions involving corporations and trusts have been decided in a way in conflict with applicable Pennsylvania and New York law. In so deciding, the Court of Appeals has erroneously chosen to disregard state rules of decision, and instead to apply a species of "general law," especially as to remedies in equity. The applicability of state rules of decision in bankruptcy reorganization proceedings and other federal *nondiversity* cases, presents a question of federal law which is recurrent and important, and which has not been, but should be, settled by this Court.[44]

The Court of Appeals reached its decision in two major steps. First, purporting to apply Pennsylvania law as to the rights (but not the remedies), the Court treated *all* the Debtor's outstanding stock as void for lack of consideration to the Debtor. Secondly, the Court distributed the beneficial ownership of the Debtor's assets anew: The Court impressed a purchase-money resulting trust on the Debtor's assets, through Malakoff as trustee, and then issued new corporate stock in lieu of direct participating interests in the Debtor's realty. In effecting the distribution, the Court below did *not* purport to apply Pennsylvania or New York rules of decision; rather, the Court applied its independent conception of "federal equity."

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[44] *See* Russell v. Todd, 309 U. S. 280, *at* 294 (1940, *per* Stone, J.) (*nondiversity*); Guaranty Trust Co. v. York, 326 U. S. 99, *at* 99-101 (1945, *per* Frankfurter, J.) (*diversity*); Holmberg v. Armbrecht, 327 U. S. 393 (1946, *per* Frankfurter, J.) (*nondiversity*); Textile Workers Union v. Lincoln Mills, 353 U. S. 448 (1957, *per* Black, J.) (*N. B.* 353 U. S. *at* 474, 482-3, *per* Frankfurter, J., *dissenting*) (*nondiversity*).

The outcome was cancellation of many shares of stock of record, reduction of other shares, and increase of the remaining shares. Thereby, the Court below erred: (a) *Executed* contracts—which had vested property rights under state law—were rejected, and property was divested, although executory (*i.e.*, unexecuted) contracts *only* may be rejected under the Bankruptcy Act[45] and the Fifth Amendment.[46] (b) Stock was *cancelled*, though applicable Pennsylvania corporation law bars such a remedy here. (c) A *resulting trust* was impressed, though applicable New York and Pennsylvania rules of decision in equity bar such a remedy here.

The issues here—as pleaded, tried, and decided—involve *only* the rights of the stock-claimants, *inter se*, all equally innocent of wrongdoing, to share in the beneficial ownership of the Debtor's assets. Those rights were created by state law; and state law should govern their adjudication. The Debtor's counterclaims against all the stock-claimants for money judgments for the stock subscription price, were denied by the District Court. Neither the Debtor nor any other party appealed from the denial of the money judgments (by contrast to the award of stock); therefore, the denial of money judgments is now final, and the Debtor is a stakeholder in a contest among stock-claimants.

1. The Court below erroneously viewed the "basic issue" or "problem" in No. 27000 as the formulation of a plan of reorganization, not as the allowance of claims to stock interests:

> "Since the problem for the reorganization court is to decide upon the capitalization necessary *to do equity* in the light of the various claims before it, this

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[45] Bankruptcy Act, § 116(1); 11 U. S. C. § 516(1); 52 Stat. 885 (1938); *see* 6 Collier on Bankruptcy (14th ed.) ¶¶ 3.23, 3.24, 3.25.

[46] *See* Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555 (1935, *per* Brandeis, J.); Schaad v. Hotel Easton Co., 369 Pa. 486, 87 A. 2d 227 (1952, *per* Stern, J.).

> court need pass *only* upon the immediate question of *who should be stockholders of the reorganized debtor* and in what proportions. With these basic principles determined, the solution becomes more clearly defined. * * *" (*App.* 37a; emphasis supplied.)

The Chapter X court cannot reach the question, Who *shall be* the stockholders of the reorganized debtor at the close of the proceedings?—until it first decides the question, Who *were* the stockholders of the Debtor at the commencement of the proceedings? Every reorganization involves at least two distinct steps or stages: *first*, determination of its creditors and stockholders, by the *allowance of claims;* and *thereafter*, provision for participation of those creditors and stockholders in the debtor's assets, by formulation of a *plan of reorganization.*[47] The first stage—the allowance of claims—is the only stage this proceeding has reached. No plan of reorganization submitted by anyone is even pending before any court in these proceedings; and no issuance of stock in a "reorganized" debtor is properly before the courts.

2. The allowance of claims of creditors and stockholders in bankruptcy proceedings is normally governed by state law.

> "A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors. What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law. * * *"[48]

> "* * * We do not reach considerations of policy in bankruptcy administration until there are rights, created by applicable local law, to be recognized."[49]

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[47] *See* 6 Collier on Bankruptcy (14th ed.) ¶ 9.02[1].

[48] Black, J., *in* Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, *at* 161 (1946).

[49] Frankfurter, J., *concurring, ibid.*, 329 U. S. *at* 171.

**3. There is no "overruling federal law" or supervening bankruptcy policy applicable in No. 27000: No substantive or positive provision of the Bankruptcy Act or any other federal statute has been invoked or would be applicable here; the rights were not federally created, and this case is no occasion to "legislate interstitially" or to "fashion federal law" as to rights or remedies.[51] The bankruptcy scheme of distribution is irrelevant to a distribution among a single class of stockholders.[52] No federal agency is a party.[53] This is *not* a suit "by a receiver of an insolvent corporation to compel its *promoters* and their *confederates* to restore illicit gains."[54] Malakoff was the "sole-actor," and is not a party. No "inequitable *conduct*" or fraud by *any* of the stock-claimants has been found by the Court of Appeals or the District Court—nor is that the basis for the disallowances below.[55]**

**4. Absent such "overruling federal law," the *Erie* principle—"outcome-determinative"—should govern in this non-diversity case, no less than in a diversity case.[56] The "equi-**

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[51b] *Cf.* McKenzie v. Irving Trust Co., 323 U. S. 365 (1945, *per* Stone, C. J.); Holmberg v. Armbrecht, *supra*, note 44; Schwabacher v. U. S., 334 U. S. 182 (1948, *per* Jackson, J.; Frankfurter, J., *dissenting*).

[52] *See* Prudence Realization Corp. v. Geist, 316 U. S. 89 (1942, *per* Stone, C. J.).

[53] *See* Bank of America Nat. Tr. & Sav. Assn. v. Parnell, 352 U. S. 29 (1956, *per* Frankfurter, J.; Black, Douglas, JJ., *dissenting*); *cf.* D'Oench, Duhme & Co. v. F. D. I. C., 315 U. S. 447 (1942, per Douglas, J.; Frankfurter, Jackson, JJ., *concurring*).

[54] *Cf.* McCandless v. Furlaud, 296 U. S. 140, *at* 149 (1935, *per* Cardozo, J.) (*emphasis supplied*).

[55] *Cf.* Taylor v. Standard Gas & Electric Co. [*In re* Deep Rock Oil Corp.], 306 U. S. 307 (1939, *per* Roberts, J.); Pepper v. Litton, 308 U. S. 295 (1939, per Douglas, J.).

[56] *See* Erie R. Co. v. Tompkins, 304 U. S. 64 (1938, *per* Brandeis, J.); Guaranty Trust Co. v. York, *supra* note 44; *cf.* Fore Improvement Corp. v. Selig, 278 F. 2d 143 (2d Cir., 1960, *per* Moore, J.; Friendly, J., *concurring*); *see also* Hill, Erie Doctrine in Bankruptcy, 66 Harv. L. Rev. 1013 (1953); 3 Collier on Bankruptcy (14th ed.) ¶ 63.03[3]; 4 *id.* ¶¶ 70.04, *n.* 31; 70.15[2], *nn.* 22-25; 70.25[2], pp. 1222-5; 70.49; 70.70[2]; 70.78.

table remedial rights doctrine" is no license here; at stake is not mere practice.[57] The statutory *remedies* here cannot be separated from the statutory *rights* under state law. The Rules of Decision Act and the Federal Rules of Civil Procedure are applicable in bankruptcy: Congress has effectually codified this Court's decisions and mandated application of state rules of decision in *all* civil actions, whether formerly cognizable at law or in equity, and irrespective of the basis of federal jurisdiction, *unless* federal law "shall otherwise require or provide."[58] The proviso is as irrelevant here as if No. 27000 were a diversity case.

5. The Court of Appeals, by disallowing stock-claims, has effectually *cancelled stock* for lack of consideration to the Debtor. Judge Moore wrote:

> "* * * From these persons [disallowed] the Debtor did not receive and was not intended to receive anything of value, either from them or *from Malakoff*. These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *
>
> "Despite the cloud of illegality obscuring *any* stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. *The Market property is sufficient to support a valid stock issue* to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. * * *" (*App.* 37a-38a; emphasis supplied.)

In other words, the Market was paid for by Malakoff, and is sufficient consideration under Pennsylvania law for the issuance of *new* stock for purposes of a plan of reorganization—but the Market is *not* sufficient consideration under Pennsylvania law for the issuance of *old* stock for purposes

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[57] *See* 2 Moore's Fed. Prac. (2d ed., 1961) ¶ 2.09.

[58] 28 U. S. C. § 1652, 62 Stat. 944 (1948); *see* Reviser's Note *thereto; and see* 6 Collier on Bankruptcy (14th ed.) ¶ 1.17; 1A Moore's Fed. Prac. (2d ed., 1961) ¶¶ 0.305[3], 0.325; Mason v. U. S., 260 U. S. 545 (1923, *per* Sutherland, J.).

of the allowance of claims![59] No reason is given—and there is no reason—why the Market (never appraised) should not have been sufficient in *value* to support a valid stock issue—old or new—to *all* the stock-claimants.

But even assuming the invalidity of the stock: The Court below completely disregarded the *exclusive remedy* spelled out by Pennsylvania statute. That disregard was more than an erroneous interpretation of state law; it was an affirmative choice of "federal equity," and a holding that the state remedy was irrelevant.

The Pennsylvania Business Corporation Law provides:

> "§ 610. Validity of Shares.—The fact that shares are issued in violation of, or without full compliance with, the provisons of this act *shall not make the shares so issued invalid*, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth."[60]

The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *"[61]

But the remedy is *not* cancellation of stock:

> "* * * However, the Pennsylvania cases are agreed that this constitutional provision [Art. XVI, § 7], standing alone, does not cause the issuance of stock without prepayment to be void. Rather, it is neces-

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[59] *See* Winston v. Saugerties Farms, Inc., 262 A. D. 435, 29 N. Y. S. 2d 292 (3d Dept., 1941, *per* Foster, J.), *aff'd.* 287 N. Y. 718, 29 N. E. 2d 934 (1942, *p. c.*); Schmidt v. Paul, 377 Pa. 377, 105 A. 2d 118 (1954, *per* Stearne, *J.*).

[60] Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P. L. 364, Art. VI, § 610 (1933) (*emphasis supplied*).

[61] Pa. Const., Art. XVI, § 7 (1874, 1956).

sary that the legislature shall *implement* the constitutionally stated policy by a statute declaring the nature and extent of any infirmity which attaches to the stock so issued, and *what may be done about it.* [Pa. cases.]" [62]

The Pennsylvania Business Corporation Law has "implemented" the Pennsylvania constitutional policy, in detail. The remedy for lack of consideration to the corporation for stock issued, is *assessment* or call—collectible like any other debt, and secured by a lien on the shares themselves.[63] Cancellation may be effected *only* after foreclosure of the corporate lien on the stock, and then *only* if public sale brings no purchase or if the corporation fails to collect a money judgment for the deficiency.[64] Assignees and transferees of subscriptions (as well as issued shares) are exonerated from assessment if their acquisitions were made "in good faith and without * * * notice" of the failure of consideration.[65] The corporation's foreclosure of any lien on the stock—including a lien for the subscription price—is barred where (as here) the stock certificates issued by the corporation bear no statement asserting such a lien.[66]

The Chapter X summary proceedings afforded the Debtor the same opportunity as a local action to obtain the relief prescribed by Pennsylvania law, namely: assessment, pre-

[62] Hastie, J., *in* Grafton v. Masteller, 232 F. 2d 773, *at* 775 (3d Cir., 1956), *cert. den.* 352 U. S. 832 (1956) (*Pa. forum; diversity jurisdiction; emphasis supplied*).

[63] Pa. Bus. Corp. L. §§ 604, 605, 609; 15 Purdon's Pa. Stats. Ann. §§ 2852-604, 605, 609; P. L. 364, Art. VI, §§ 604, 605, 609 (1933).

[64] *Ibid.*, § 605.

[65] *Ibid.*, § 609.

[66] 15 Purdon's Pa. Stats. Ann. § 315; P. L. 120, § 15 (1911) (*identical to* Uniform Stock Transfer Act, § 15) (*repealed and replaced by* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] §§ 8-103, 8-204; P. L. 3, §§ 8-103, 8-204 [1953], *effective* July 1, 1954); *see* Bubbis v. Duffy & Bros., Inc., 14 Pa. D. & C. 281 (C. P., Phila., 1930, *per* Alessandroni, J.).

requisite to cancellation. The Debtor could—and did—sue the stock-claimants (who had appeared generally) for the allegedly unpaid subscription price. Liability to assessment is altogether a matter of Pennsylvania law.[67] Absent appeal, the District Court's denial of assessment is *res judicata*.[68] Whatever relief the parties may now have, that relief cannot be cancellation of stock.

6. Having cancelled all the outstanding stock (despite the Pennsylvania law), the Court of Appeals then impressed a *purchase-money resulting trust*. What began as a distribution of the *Debtor's* assets, finished as a distribution of *Malakoff's* assets. Judge Moore wrote:

> "* * * The sellers (Philadelphia group) have been paid for that [Market] property by Malakoff. Malakoff in turn obtained the money *for this purpose* from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) *for those who gave him their funds for investment in the project.* They should in equity receive that for which they paid." (*App.* 38a-39a; emphasis supplied.)

Applicable state law bars such a remedy. For the rules of decision in *equity* in both New York and Pennsylvania—binding in diversity cases[69]—preclude the resulting trust impressed below.

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[67] Harrigan v. Bergdoll, 270 U. S. 560 (1926, *per* Brandeis, J.); *see* 4 Collier on Bankruptcy (14th ed.) ¶ 70.29[2].

[68] *See* Angel v. Bullington, 330 U. S. 183 (1947, *per* Frankfurter, J.).

[69] Ruhlin v. N. Y. Life Ins. Co., 304 U. S. 202 (1938, *per* Reed, J.); Cities Service Oil Corp. v. Dunlap, 308 U. S. 208 (1939, *per* McReynolds, J.).

In *New York*, resulting trusts have been abolished altogether.[70] What remain are the *express trust* (subject to the statute of frauds) and the *constructive trust* (or "implied" or "fraud-rectifying" trust).[71] An express trust or a constructive trust here would have allowed the prevailing stock-claimants *precisely* "that for which they paid" (*App.* 39a)—*e.g.*, in Weinstein's case, 7/200 or 3.5% under his letter-receipt from Malakoff, instead of 4.79% as awarded to him below.

In *Pennsylvania*, resulting trusts, though not abolished, have been severely curtailed by statute and case-law. A purchase-money resulting trust could operate here in favor of an "investor" *only* if his advances had been made to Malakoff *before* Malakoff had paid the purchase price of the realty to the Philadelphia Group. *Subsequent* advances, even if used for improvement of the realty or for satisfaction of liens on the realty, would at most give the "investor" an equitable lien for recovery of his "investment"—but *not* equitable ownership of the realty.[72] Here, Malakoff is said to have paid the Philadelphia Group a total of $77,010.84, and to have received a total of $79,025 from "investors", all *before* February 15, 1952 (*App.* 35a). Yet, "investments" aggregating $145,987.34— almost half advanced *after* that date—have been allowed (*App.* 40a-41a, 45a). Under Pennsylvania law, those later "investors" *cannot* be *cestuis* of a purchase-money

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[70] N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) §§ 91, 94.

[71] Fraw Realty Co., Inc. v. Natanson, 261 N. Y. 396, 185 N. E. 679 (1933, *per* Kellogg, J.); *In re* Cohen's Estate, 137 N. Y. S. 2d 300 (Sup., N. Y., 1954, *per* Walter, J.), *affd.* 285 A. D. 1119, 141 N. Y. S. 2d 819 (1st Dept., 1955), *affd.* 309 N. Y. 935, 132 N. E. 2d 311 (1955).

[72] Musselman v. Myers, 240 Pa., 5, 87 A. 425 (1913, *per curiam*); Farmers Trust Co. v. Bevis, 331 Pa. 89, 200 A. 54 (1938, *per* Drew, J.); Majors v. Majors, 349 Pa. 334, 37 A. 2d 528 (1944, *per* Hughes, J.). *Accord*: Olcott v. Bynum, 84 U. S. 44 (1873, *per* Swayne, J.).

resulting trust. Likewise, they *cannot* be "good-faith purchasers": [73] In purchasing the realty, Malakoff is said to have acted for the "investors", not for himself or the sellers (*App.* 39a); therefore, the later "investors" are charged with *notice* of Malakoff's wrongdoing.[74] Under Pennsylvania law, their claims are entitled to no better standing than the stock-claims which were disallowed below because consideration was "antecedent indebtedness".

Thus, the peculiar resulting trust impressed below—advocated by Weinstein and Fried in their joint briefs below, and barred by both New York and Pennsylvania law—is the sole "equitable" device which can penalize 6 stock-claimants, while enriching 30 others, for Malakoff's individual wrongdoing—of which all 36 have been found equally innocent.

7. The primary issue here is whether federal or state law applies. A conflict of laws between the applicable New York and Pennsylvania rules of decision as to resulting trusts, would require a choice of state law by a federal court in a nondiversity case—a matter expressly left unsettled by this Court at least three times since *Erie*.[75]

* * *

The foregoing discussion has assumed (*arguendo*) that the Court of Appeals' statement of facts was correct. However, its statement of facts was *not* correct. The major errors (among many) were: (1) *tracing* of the purchase price of the Market, thus setting aside the District Court's finding of *no-tracing;* and (2) *intention* of the prevailing stock-claimants to deal with Malakoff in a *fiduciary* capacity,

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[73] 21 Purdon's Pa. Stats. Ann. § 601; P. L. 425, § 1 (1901).

[74] Curtis, Collis & Holbrook Co. v. U. S., 262 U. S. 215 (1923, *per* Taft, C. J.).

[75] D'Oench, Duhme & Co. v. F. D. I. C., *supra* note 53, 315 U. S. *at* 456; McKenzie v. Irving Trust Co., *supra* note 51, 323 U. S. *at* 371, n. 2; Vanston Bondholders Protective Committee v. Green, *supra* note 48, 329 U. S. *at* 162. *Cf.* Klaxon Co. v. Stentor Electric Mfg. Co., Inc., 313 U. S. 487 (1941, *per* Reed, J.). *See* Goodrich, Two States and Real Estate, 89 U. of Pa. L. Rev. 417 (1941).

thus setting aside the District Court's finding that *all* 36 stock-claimants intended to deal with Malakoff in his individual capacity as stockholder-seller. The appellate substitution of findings, of course, was essential to the impression of a purchase-money resulting trust. (The conclusiveness of the District Court's findings of fact under Rule 52(a),[76] is the principal subject of the unsuccessful petition for rehearing of No. 27000 below [No. 27000: R 42a].)

The District Court's findings were not "clearly erroneous"; indeed, they were the only reasonable findings of fact on the evidence. In substituting its own findings of fact, the Court of Appeals has committed an egregious violation of Rule 52(a) and has acted outside the proper scope of appellate review. Thereby, the Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

* * *

In sum: It was a veritable fortuity that No. 27000 should have been litigated in a bankruptcy court at all. No reason, no law, and no equity should differentiate between the adjudication of the stock-claims in a federal reorganization court and the adjudication of the stock-claims in a state court (or in a federal court with diversity jurisdiction). The Chapter X court is bound to follow state law in determining the rights of the stock-claimants *inter se* to share in the Debtor's assets. The applicable *state* law, disregarded below, bars the remedy below. The principal *federal* law applicable is procedural—Rule 52(a)—which the Court of Appeals also disregarded. Assuming to act without the guidance of any federal or state statute or policy, the Court of Appeals has engaged in an exercise of naked power based on subjective notions of "equity." The "chancellor's foot," as a federal standard, was part of the "brooding omni-

[76] Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072.

presence" outlawed by *Erie*. This Court thereby formulated a new "way of looking at law" [77]—which should apply irrespective of the jurisdictional ground.

## Conclusion

In No. 26362, the Court below applied state rules of decision to a federal question—the administration during reorganization of an estate in the custody of a federal court. In No. 27000, the Court below applied federal rules of decision to a state question—the allowance of claims to stock interests which had vested under state law prior to reorganization. The questions involved in No. 26362 and No. 27000—what rules of decision are applicable in Chapter X proceedings (and other nondiversity cases)—are related, recurrent, and important, and should be settled by this Court.

For the reasons set forth above, it is respectfully submitted that this Petition for Writs of Certiorari should be granted.

Dated: New York, New York
February 21, 1962

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[77] Guaranty Trust Co. v. York, *supra* note 44, 326 U. S. *at* 101.

## Appendix A

## Opinion Below in No. 27000

(Argued August 17, 1961—Decided November 9, 1961.)

Before: MOORE, FRIENDLY and SMITH, *Circuit Judges*.

Appeals in Docket No. 27000 from an order made on December 8, 1960 (Sugarman, *D.J.*) in a Chapter X, Bankruptcy Act, proceeding in the United States District Court for the Southern District of New York, resolving the stock interests in the Debtor of 36 claimants. Order reversed except as specified in opinion.

Appeals by the Debtor and J. Fried in Docket No. 26962 from an order made on April 10, 1961 (Sugarman, *D.J.*) in a Chapter X, Bankruptcy Act, proceeding in the United States District Court for the Southern District of New York, granting a petition to reopen proceedings in connection with petitions to review an order of a Referee in Bankruptcy made October 5, 1957, disallowing stock claims of 5 claimants and to receive in evidence in support of such petitions to review, the minutes of all hearings relating to the stock claimants in Docket No. 27000 and to take further testimony. Order affirmed as to reception of so much of the minutes as does not concern evidence peculiar to the claimants concerned in Docket No. 27000; otherwise reversed. On the petitions to review the order of the Referee in Bankruptcy, the district court is directed to modify the order of October 5, 1957, in accordance with this opinion.

MOORE, *Circuit Judge*:

The two cases (Nos. 26962 and 27000) consolidated on this appeal both involve the resolution of stock claims in Nazareth Fairgrounds & Farmers Market, Inc. (the Debtor), a corporation being reorganized under Chapter X of the

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Bankruptcy Act. No. 26962 involves five stock claimants (54 shares) and is an appeal from an order of the District Court which reopened the proceedings on a petition to review a decision of the Referee denying the stock claims of the five claimants therein. No. 27000 is an appeal from an order of the District Court settling and allowing the stock claims of the thirty-six claimants (262 shares) therein.

The Debtor was organized on August 7, 1951, as part of a plan to transfer the ownership of a farmers' market in Nazareth, Pennsylvania, a parcel of some 32 acres and buildings, from a group consisting of Edward Malakoff, Maurice Malakoff, Milton Zoloth and Morris Soble (the Philadelphia Group) to John Malakoff (Malakoff). Previously thereto on April 17, 1951, the Philadelphia Group through a controlled corporation, Richard Realty Co., purchased this property from its then owner, Nazareth Fairgrounds, Inc., for $66,000. John Malakoff had one-quarter interest in the original purchase of the property by the Philadelphia Group. On May 14, 1951, for corporate and tax reasons Richard Realty Co. conveyed the property subject to mortgages to Kipling Realty Co. (also a Philadelphia Group controlled corporation) for $100.

In July, 1951, John Malakoff orally agreed (so found by Examiner and trial court) to purchase the Philadelphia Group's interest in the property for $66,000 plus an undetermined amount, alleged to have been $30,000. The Articles of Incorporation of the Debtor which were executed on August 1, 1951, provided for an authorized capital of 200 shares with a stated capital applicable thereto of $120,000. The first meeting of the directors of the Debtor authorized the purchase of the Nazareth property from Zoloth and Soble for twenty shares of the corporation's stock and the assumption of all obligations by the corporation, including amounts shown as loans payable to the Philadelphia Group. About August 8, 1951, stock certificate #1 for 10 shares was issued

to Milton Zoloth and certificate #2 for 10 shares was issued to Morris Soble. On October 17, 1951, a contract was executed between John Malakoff and Zoloth and Soble whereby Malakoff purchased their 20 shares of stock for $32,853.08; $2,853.08 was paid on execution of the contract and the remaining $30,000 was to be paid in 10 monthly installments of $3,000. Title to the stock was to pass on the execution of the contract but the stock was to be held in escrow until the payment of the $30,000. On October 17, 1951, Zoloth endorsed stock certificate #1 over to Malakoff and on October 22, 1951, Soble endorsed certificate #2 to Malakoff. On June 17, 1953, Malakoff endorsed these certificates over to the Debtor, and executed a release of all claims against the Debtor.

The certificates and corporate books were not turned over to Malakoff until December, 1952, although he had been managing the business since October, 1951.

In April, 1951, Malakoff started to solicit investments in the Nazareth enterprise, promising investors a 20% return on their capital. Generally, shares were offered at a rate of $1,000 a share, although some investors paid only $600 a share.

Between April 1, 1951, and February 15, 1952, Malakoff received from investors in the Nazareth venture $79,025 and paid to the Philadelphia Group $77,010.84; the latter figure includes $11,032.84 received in payment of an insurance claim for windstorm damage. However, at no time did the amount that John Malakoff paid to the Philadelphia Group exceed the amount which he had already collected from investors. Until he became insolvent in June, 1953, Malakoff paid monthly "dividends" to the investors based on a 20% annual return on their original investments. These "dividends" were paid in Ponzi-like [1] manner out of new money received

[1] See *Cunningham* v. *Brown*, 265 U. S. 1 (1924).

from investors in the Nazareth Market. The corporation did not have a profit from which dividends could have been paid during this period. Shares of stock were issued to the claimants herein on and after February 2, 1953, and none can be said to have been issued in a regular manner, that is, upon receipt of consideration passing directly to the Debtor. Moreover, the consideration for which the stock in Nazareth was issued was not the same in all cases: some investors gave Malakoff cash or checks; others received their interest in Nazareth by releasing funds which Malakoff held for them as proceeds from other ventures; others accepted Nazareth stock from Malakoff in exchange for stock in other Malakoff ventures that had proved worthless; and some of the claimants received interests in Nazareth in satisfaction of Malakoff's personal debts to them. In substantially all cases the certificates were not issued to the stock claimants at or about the time they allegedly gave consideration to Malakoff as an investment in Nazareth. Altogether 316 shares were issued, 116 more than were authorized, to the 41 claimants herein. On September 28, 1953, the Debtor filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. To achieve a reorganization of the Debtor which, insofar as stock issuance and ownership are concerned, never had been properly organized, the trial court had to determine as a basic issue: who, if any, were entitled to participate in the stock of the reorganized Debtor. The Court referred the task of making this investigation to an Examiner (Bankruptcy Act of 1898, §§ 167, 168; 11 U. S. C. A. 567, 568). Testimony (some 10,000 pages) was taken concerning the circumstances under which the stock claimants had purportedly invested in the Nazareth Market or claimed to be entitled to participate as stockholders of the Debtor. In a detailed and painstaking report (236 pages), the Examiner carefully sifted the issues fundamental to the resolution of stock participation.

## *Appendix A*

In summary, he found that every claimant had acquired his or her stock by means of transactions with Malakoff or his agents; that none of the consideration therefor passed directly to the Debtor; that Malakoff and the claimants "ascribed little or no importance to the legal form which the venture took, or to the observance of the legal and other formalities and requisites of its corporate form"; that not one of the claimants "has a clear legal right to any of the shares which he or she claims"; and that he (the Examiner) should "apply equitable principles in the determination of who are the stockholders of the debtor and what proportions of its stock they hold."

Since the problem for the reorganization court is to decide upon the capitalization necessary to do equity in the light of the various claims before it, this court need pass only upon the immediate question of who should be stockholders of the reorganized debtor and in what proportions. With these basic principles determined, the solution becomes more clearly defined. One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth Market. The money was solicited for this purpose by Malakoff as the promoter of the enterprise and was not intended to be loans to Malakoff personally or to be used generally by him in his many business operations. The funds should have reached the Debtor's treasury and have been the consideration required by Pennsylvania law[2] to support the valid issuance of the Debtor's shares. The other group consists of persons to whom Malakoff issued shares for antecedent personal debts, in exchange or substitution for shares of other ventures or for other obligations personal to Malakoff. From

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[2] "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void." Pa. Const. art. XVI, § 7, implemented in 15 Purdon's Pa. Stat. § 2852-603(A) (1958).

these persons the Debtor did not receive and was not intended to receive anything of value, either from them or from Malakoff. These shares as a matter of Pennsylvania law could have had no validity as an original issue. In many instances, however, Malakoff gave by assignment to persons in this group shares purportedly issued to him. Had these shares been validly issued to Malakoff then, but only then, would the principles of the Uniform Stock Transfer Act [3] in force in Pennsylvania at the time of the transactions here involved as to consideration and "value" apply. But no such shares were ever validly issued to Malakoff. The 20 shares originally issued to Zoloth and Soble, although subsequently assigned to Malakoff and still later by him to the Debtor, did not come into the hands of any claimant. After the shares had been issued to the claimants from and after February 2, 1953, corporate minutes in May or June, 1953, were fraudulently prepared and pre-dated as of July 2, 1952 (or post-dated as of July 2, 1953) purporting to evidence the issuance of the remaining 180 shares to Malakoff for $75 a share. There is no proof that Malakoff ever paid for these shares or that they were legally issued. Thus no claimant can derive any rights by assignments from Malakoff on the theory that he was the owner of the Debtor's stock. The purported issuance was both fraudulent and invalid.

Despite the cloud of illegality obscuring any stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. The Market property is sufficient to support a valid stock issue to those entitled thereto. The sellers (Philadelphia group) have been paid for that property by Malakoff. Malakoff in turn

[3] "'Value' is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security thereof." Uniform Stock Transfer Act § 22(1), 15 Purdon's Pa. Stat. § 322, now covered by Uniform Commercial Code § 8-303, 12 A Purdon's Pa. Stat. § 8-303 (1958).

obtained the money for this purpose from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) for those who gave him their funds for investment in the project. They should in equity receive that for which they paid.

Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclusions are at variance with the equitable principles applicable here. The Examiner treated Malakoff as the owner and operator of the Debtor and each claimant as having purchased his interest from Malakoff. This erroneous assumption made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Act's definition of "value" were satisfied. This, however, is not the problem. The Debtor's stock for all practical purposes has never been legally issued. Such stock as is to be issued in the reorganization should be based upon the requirements of Pennsylvania law with respect to the issuance of stock.[4]

Malakoff received the moneys put into his hands by the investors for the specific purpose of the allotment of shares in the Nazareth Market property. He used some of this money to acquire that property. Title thereto now is in the Debtor. The court upon reorganization is in a position to give to the investors that which they were originally entitled to receive.

At the time Malakoff obtained the investors' funds, he spoke in terms of the issuance of shares. To some he promised shares at $600; to others at $1,000. Although

[4] See footnote "2," *supra*.

shares were purportedly issued, the "dividends" of 20% were paid and accepted on the basis of the amount invested. Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares. The "investors" had a right to expect that the sums delivered to Malakoff would represent their shares in the enterprise and would be delivered to the corporation. Therefore, in determining their interests the entire amount paid, undiminished by any so-called "dividends," must control their participation.

As to the stock claimants, with few exceptions they fall into two distinct categories: (1) those investors who paid for a participation in the Nazareth Market by cash, check or credit, and (2) those who did not make any payment but who rely upon antecedent indebtedness of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration.

In the first category are the claimants listed below whose claims should be allowed in the amounts indicated. As to these claimants, the findings of the Examiner and the trial court relating to the amounts paid to Malakoff and the circumstances under which they were paid are affirmed.

| *Name* | *Amount* |
|---|---|
| Charles Kanter | $ 4,000.00 |
| Morton Samet | 2,000.00 |
| Gertrude Klein | 14,000.00 |
| Dorothy Holober Clark | 3,000.00 |
| Barry Clark | 4,000.00 |
| Harold Q. Masur | 4,000.00 |
| Louis Como | 6,000.00 |
| Frank Como | 6,000.00 |
| Patsy Como | 8,000.00 |
| Anne Bikales | 5,000.00 |
| Lawrence Treat | 2,000.00 |
| Dorothy Kane | 3,000.00 |

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| | |
|---|---|
| Miriam Klein | 3,350.00 |
| Ruth Spielholz | 3,000.00 |
| Mae Bluestone | 2,000.00 |
| Gussie Schwartz | 2,000.00 |
| Harold B. Schwartz | 4,000.00 |
| Lazar Karapantso | 2,000.00 |
| Ernest Pollak | 9,000.00 |
| H. Lawrence Laupheimer | 7,750.00 |
| Arnold A. Weinstein | 7,000.00 |
| Aaron Fried | 3,000.00 |
| George Bond | 1,000.00 |
| Tess J. Schwartz | 3,000.00 |
| Cydney Grosman | 2,000.00 |
| Rose Kaplan | 1,000.00 |
| Robert A. Noire | 5,000.00 |
| Richard S. Hull | 3,600.00 |
| Leslie Saul | 3,000.00 |
| Jerome Fried | 2,000.00 |
| Ann Rosen | 6,000.00 |

*Charles Kanter*

As to the claimant, Kanter, there must be some modification of the Examiner's and trial court's conclusions. The Examiner found that after Malakoff in early 1951 had agreed to take a one-quarter interest in the Nazareth Market for $16,000, Kanter took one-quarter of this amount for $4,000 and gave Malakoff a check for $2,667 and cash or customers' checks for $1,333.33. Although Malakoff's promissory note for $4,000, dated April 11, 1951, signed as "Agent," is somewhat in conflict with the investment theory, nevertheless it is endorsed "For 1/16th of interest in Nazareth Market." Therefore, $4,000 may properly be placed in the investment category. The balance of Kanter's claim falls into the second category and must be disallowed.

In the second category are the claims which must be disallowed.

*Herbert and Melvin Danciger*

The Dancigers' claim is based upon a certificate for 11 shares given to them by Malakoff to secure a personal obligation arising out of a real estate operation unrelated to the Nazareth Market. The entire claim must be disallowed.

*Seymour Forman*

This claim to 15 shares is based upon a certificate for 15 shares issued in Malakoff's name and endorsed by him to Forman. Even this claimant does not contend that he intended to invest in Nazareth. At most, the shares (invalidly issued) were to secure loans. If Forman has a claim based upon a loan for $5,000, or any other amount, to the Debtor, it must be considered independently of any claim to a stock interest. The stock claim must be disallowed.

*Eskandar Manoochehrian*

This claim is based upon two certificates totalling 20 shares. The claimant himself states the consideration to have been a loan of $20,000 to a corporation other than the Debtor. The claim clearly comes within the second category and must be disallowed in its entirety.

*H. Forman*

The claim for 10 shares involves two certificates for 5 shares each dated March 13, 1953, and April 23, 1953, respectively. The Examiner found that "At that time there were no open transactions between Forman and Malakoff

and neither one owed the other any money"; that Forman delivered a check for $5,000 dated April 23, 1953, payable to Malakoff to cover Forman's agreement to buy 5 shares in the Nazareth project; that "It is perfectly plain that the transaction Forman had with Malakoff on or about the 17th day of March, 1953, was a security transaction so far as the Nazareth stock was concerned"; and that the second certificate "likewise seems to have been a security transaction despite Forman's testimony to the contrary." The April, 1953, payment of $5,000 for 5 shares is claimed to have been for an investment in Nazareth. However, the Examiner has found to the contrary on conflicting evidence and no showing has been made that such a finding is clearly erroneous. As a result, these facts place this claim in the second category and it must be disallowed.

*Frederick Katzenell*

Katzenell bases his claim upon an alleged Malakoff antecedent indebtedness of $28,000 and a $2,000 check given to Malakoff in September, 1951. The check, however, bears Katzenell's own notation of "loan." Neither the antecedent debt nor the loan support an investment in Nazareth and, hence, his claim must be disallowed.

Another group (the Margolis group) involved in a separate appeal (No. 26962) must be considered as potential participants. The Referee in Bankruptcy found no equity in favor of any claimant in this group, i.e., Benjamin Margolis (17 shares), William McK. Shongut (10 shares), Bernard Ungar (2 shares), Ida Margolis (15 shares) and Sarah Kason (10 shares).

Despite the fact that the Margolis appeal relates directly only to the district court's order permitting a reopening of the proceedings as to this group, there is sufficient proof before this court to enable us to indicate our views as to the rights of these claimants.

## *Appendix A*

The claims of three of the five claimants in appeal No. 26962, Benjamin Margolis, Bernard Ungar and Sarah Kason, should be completely disallowed. These claims are based on certificates which were issued in satisfaction of Malakoff's personal debts or to replace worthless stock in other Malakoff ventures. The claims of William McK. Shongut and Ida Margolis should be allowed in part.

### *Benjamin Margolis*

Benjamin Margolis claimed 17 shares, purchased in units of 10 and 9 (2 of the latter group were sold to claimant Ungar). For the former group, the consideration was debts owed personally by Malakoff to Mr. and Mrs. Margolis. For the latter, Margolis turned over shares in Wales Properties, Inc. (another Malakoff venture), specifically found by the Referee to be worthless. All of Margolis's claims should, therefore, be denied.

### *Berngrd Ungar*

Ungar gave Margolis $2,000 for two shares of Margolis's stock. Since this stock was never validly issued to Margolis, Ungar could obtain no better rights thereto. His only remedy is against Margolis.

### *Sarah Kason*

Sarah Kason, Ida Margolis's mother, held 10 shares. The Referee found that these shares were issued as security for money previously loaned to Malakoff personally by Ida Margolis, despite the fact that Mrs. Margolis claims the loans to have been to Nazareth. This finding appears reasonable and, therefore, the Kason claim should be denied.

### *William McK. Shongut*

Shongut's 10 shares were acquired pursuant to an alleged agreement with Margolis whereby he delivered to Margolis,

as attorney, his check for $10,000. Margolis deposited this check in his bank account and Margolis guaranteed Shongut an income on the stock of 20% a year for 6 years. Shongut actually had given this $10,000 to Margolis for investment in Nazareth. However, Margolis only gave by checks and cash $6,287.34 to Malakoff. Shongut, therefore, should be allowed $6,287.34; for the rest he must look to Margolis.

*Ida Margolis*

In 1951 Ida Margolis paid to Malakoff $9,000 for 15 shares. This amount should be treated in the same manner as the allowed claims in appeal No. 27,000. The remainder of her claim, however, is based on stock issued to her in payment of a personal debt of Malakoff and, therefore, must be disallowed.

All Margolis group claims should be disallowed except those of Ida Margolis for $9,000 and Shongut for $6,287.34, which should be allowed.

There remains for consideration the proper treatment which should be accorded the "dividend" payments. Moneys paid by investors, which should have been turned over to Debtor but were diverted to persons whose stock claims are disallowed, belonged in equity to the Debtor. However, the rights of the Debtor with respect to such recoupment, if any, as may be just and proper, are not within the issues on this appeal. Insofar as "dividend" payments were made to and received by claimants whose claims are allowed, the sums were obviously not dividends because there were no earnings to support such payments. They could therefore only be regarded as distributions out of the Debtor's capital. The amounts received as found by the trial court should be a charge against any distributions to be made to these stockholders and any shares issued upon reorganization so

endorsed or stamped as to indicate this liability to subsequent purchasers or transferees.

This opinion deals with the rights of the original recipients of Nazareth stock. There have been some transfers, including those noted in Docket No. 26,362 decided simultaneously herewith, dealing with certain purchases and sales by claimants, Weinstein and J. Fried. The conclusions in this opinion are without prejudice to such action as equitable principles may require with respect to these two claimants or others who have bought or sold stock.

Appellants' contention in No. 26,962 that the district court could not open the petition for review and receive new evidence, including the minutes of the hearings on the stock claims involved in appeal No. 27,000, is without merit. General Order No. 47 gives the district court the right[4] to receive further evidence after receipt of a referee's report.[5] The necessity for such a rule is demonstrated by the facts presented in this case. The Referee's decision, that none of the claimants could recover because none of them gave consideration which passed directly to the corporation, was wrong. In order to make an equitable determination of the claims presented by these five claimants, the district court deemed it necessary (probably for comparative purposes) to consider the factual basis for the allowance of the claims of the other claimants. In view of our disposition of the claims in Docket No. 27,000 and our views as to the claims in Docket No. 26,962 further evidence beyond that already available to the court would seem to be unnecessary.

This reorganization has been pending for over eight years. The Farmers Market appears to be a currently profitable operation. A rapid termination of the proceeding would be in the interest of the claimants and the courts, thus giving

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[5] *In the Matter of Kaufhold*, 3rd Cir., 1958, 256 F. 2d 181; *Powell v. Wumkes*, 3rd Cir, 1942, 142 F. 2d 4.

to those who some ten years ago thought that they were investing in the Market that which they should have received at the time.

The order in =27,000 is reversed except as specified in this opinion. The order in =26,962 is affirmed as to reception of so much of the minutes as does not concern evidence peculiar to the claimants in =27,000; otherwise, reversed. On the petitions to review the order of the Referee in Bankruptcy, the district court is directed to modify the order of October 5, 1957, in accordance with this opinion. No costs in Dockets =27,000 and =26,962.

**Rehearing of No. 26962**

The petition for rehearing is denied.

The value, if any, of the Wales stock is immaterial. At most, the nine shares of Nazareth stock claimed by Benjamin Margolis were issued as an exchange and not for an investment in Nazareth. As to the Sarah Kason stock, the use to which Malakoff put the loan (i.e., payment of "dividends" to Nazareth "stockholders") does not change the loan to legal consideration for the issuance of Nazareth stock.

December 22, 1961.

## Appendix B

## Opinion Below in No. 26362

(Argued August 17, 1961—Decided November 9, 1961.)

Before: MOORE, FRIENDLY and SMITH, *Circuit Judges*.

Weinstein, president of the debtor, and Fried, its general manager, appeal from so much of an order of the District Court for the Southern District of New York, Sidney Sugarman, *J.*, as prohibited Weinstein from having anything further to do with the operation of its business and discharged Fried from its employ, approved the election of one Philip as director and treasurer, prohibited disbursal of funds except on Philip's countersignature, and authorized Philip to supervise the debtor's affairs pending employment of a new general manager. Wolf and other stockholders cross-appeal from so much of the order as failed to order Weinstein and Fried to reimburse compensation and expense moneys already received. Reversed on Weinstein's and Fried's appeal save for approval of election of directors and officers; affirmed on cross-appeal.

FRIENDLY, *Circuit Judge*:

The skeins from which Nazareth Fairgrounds & Farmers' Market, Inc. (hereafter Nazareth) began, and the lengthy efforts to unravel them, are recounted in my brother Moore's opinion in Nos. 27000 and 26962, this day decided. The instant appeals relate to a chapter in the Nazareth epic which, if scarcely modern, is at least more recent. The principal issue is the applicability to an officer and to a general manager of a debtor in possession, who have been receiving compensation pursuant to § 191 of the Bankruptcy Act, of Section 249, which provides:

> "Any persons seeking compensation for services rendered or reimbursement for costs and expenses in-

> curred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

We hold the section inapplicable.

Nazareth filed its petition for reorganization under Chapter X in September, 1953. Weinstein was then its president and Fried general manager.[1] The petition prayed that the "petitioner by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of your petitioner." The Court left the debtor in possession and authorized it to pay $100 a week to Fried, then described as secretary-treasurer, and nothing to Weinstein. Later the salary of Fried, then described as general manager, was increased, first to $150 and then to $200 a week, and Weinstein was awarded compensation of $50 a week. Fried, who is located at Nazareth, Pa., has been in active charge of the day-to-day operations of the debtor; Weinstein, a New York attorney, has made regular inspection trips and has passed on leases and other general policy matters. The administration has been successful, gross business having tripled from 1953 to 1959 and profits having risen from zero to $41,269.

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[1] Fried had previously been a director and secretary-treasurer; he resigned these offices on June 29, 1953.

*Appendix B*

In the course of administration a bitter contest for control arose between the stockholders who had elected Weinstein and Fried and an opposition group with which appellees are identified, known as the Rehrig group, Rehrig being a tenant of the debtor. In August, 1958, an election of directors was held, at which Weinstein, Herbert Danciger (not in either group), and Philip (Rehrig's attorney) were elected; they thereupon chose Weinstein as President, one Laupheimer as Vice President, Danciger as Secretary, and Philip as Treasurer. All this was subject to the Court's approval, as required by § 191; among the welter of petitions in this proceeding was one, verified August 6, 1958, but not decided until June 14, 1960, asking for that.

In March, 1959, appellees submitted a "Petition for Termination and Recoupment of Compensation (Pursuant to § 249 of the Bankruptcy Act)." The petition alleged that Weinstein's sister had purchased six shares of the debtor's stock in 1957; that in 1958 and 1959 Weinstein had purchased three shares, and sold a fraction of one; that in 1959 he or persons represented by him had exercised options to purchase six shares; that Fried had bought twenty shares in 1957 of which he had sold ten back to the vendor in 1958; and that these transactions violated § 249 and required the termination of appellants' compensation and the return of salary and expense moneys previously received. Weinstein filed an answering affidavit disclaiming responsibility for his sister's purchase and taking the position that his own purchases were made from stockholders who had tired of the long delays and insisted on selling to someone despite Weinstein's advice that they keep their stock—also that as to most of the stock, he was buying pursuant to options which had been arranged, in order to prevent a "raid" by Rehrig, on a basis that might result in others participating in the purchase nominally being made by him. He alleged also "that until now I was not aware of section 249 of the Bankruptcy Act," although conceding that he was "chargeable with knowledge of its

provisions." This was followed, a month later, by an order requiring appellees to show cause why their petition should not be dismissed pursuant to F. R. Civ. Proc. 12(b), with leave to appellants to answer in the event of denial.

The Court sent the matter to a referee for hearing and report; Referee Joyce recommended that the motion to dismiss be granted. When his report came before the District Judge in January, 1960, the judge filed a memorandum disapproving the Referee's ruling and setting a hearing for proof bearing on "recoupment" of past compensation and expense moneys. Such a hearing was held on June 14; at its conclusion, the judge directed from the bench that Fried be discharged as general manager, that Weinstein have nothing further to do with the operation of debtor's business, that the prayer for "recoupment" be denied, that the election of directors and officers be approved, that no funds should be disbursed save on Philip's countersignature, and that Philip should supervise the debtor's affairs pending the early appointment of a new general manager. Weinstein and Fried appealed from all of the order save for the denial of "recoupment" and so much of the approval of the election as did not relate to Philip; appellees cross-appealed from the former. On motion of Weinstein and Fried, offering to serve without compensation unless the order should be reversed, this Court, on July 12, 1960, stayed so much of the order as removed them from participation in the debtor's affairs and designated Philip in their stead, with leave to the District Judge to file more detailed findings of fact and conclusions of law. These make plain that "Weinstein's and Fried's dissociation from the management" of the debtor was directed "solely because they, as fiduciaries, violated section 249 of the Bankruptcy Act by dealing in the debtor's stock."[2]

[2] The judge had previously said orally at the hearing on June 14, 1960, that "in view of the Court's disposition of the petition for termination of compensation to Messrs. Weinstein and Fried, they can no longer function in their respective offices * * *"

When granting the stay, we had supposed the appeals would be heard in the fall of 1960; however, they were not argued until a special sitting on August 17, 1961. On Weinstein's and Fried's appeal we reverse, save as to the approval of the election of directors and officers; this reversal leads to affirmance on the cross-appeal.

We assume that, under the wide powers conferred by § 188 of the Bankruptcy Act, the District Court might permissibly conclude that an officer or employee of a debtor who had disentitled himself to receive compensation should no longer be allowed to serve even if his service was otherwise in the best interests of the estate. The question thus is whether appellants had done that.

Section 249 finds its source in two district court decisions, *In re Paramount-Publix Corp.*, 12 F. Supp. 823 (S. D. N. Y. 1935), and *In re Republic Gas Corp.*, 35 F. Supp. 300 (S. D. N. Y. 1936), denying compensation to members of committees who had traded in securities of a debtor in reorganization under § 77B of the Bankruptcy Act, 48 Stat. 912 (1934), the predecessor of Chapter X, see also *In re Mountain States Power Co.*, 118 F. 2d 405, 407 (3 Cir. 1941). Referring to these cases, the draftsmen of the Chandler Act explained that § 249 was "a development of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law" and constituted "a step toward the codification" of the rule laid down in the district court decisions, "an attempt to make it more uniform," and "broaden the base a little bit."[3] Decision whether the base was broadened so as to include an officer and a supervisory employee of a debtor in possession

[3] 75th Cong. 1st Sess., Hearings before the Committee on the Judiciary of the House of Representatives on H. R. 6439, pp. 183-184.

demands some examination of the latter concept and of the structure of the statute. Here, as in *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216, 218 (1936), "there is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts."

The concept of leaving of a debtor in possession, "A receivership without a receiver," [4] was one of the many innovations introduced by § 77B to meet the insolvency problems of the great depression. The thought was that expense could be saved and perhaps efficiency gained by avoiding the universal appointment of trustees and continuing, in appropriate cases, the possession of corporate managements whose calamities, in many instances, had been due to national or even international economic forces quite beyond their control. After much debate, this practice was carried into Chapter X, in considerably reduced scope. The provisions dealing with it are found in Article VII—Proceedings Subsequent to Approval of Petition, §§ 156, 159, 162, 163, 168, and 170, and in Article VIII—Title, Rights, and Powers of Trustees and Debtors in Possession, especially §§ 188, 189, 190 and 191. The first sentence of § 191 provides "A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court." The orders with respect to Weinstein's employment were made pursuant to that section, and the orders with respect to Fried were evidently intended to be.

On the other hand, § 249 is contained in Article XIII, entitled "Compensation and Allowances." The initial sections, 241-246, describe the persons to whom reimbursement for costs and expenses and compensation for services rendered may be made. These include the referee, special

[4] Judge (then SEC Commissioner) Frank, 75th Cong. 2d Sess., Hearings before the Committee on the Judiciary of the Senate on H. R. 8046, p. 99, quoted in 6 Collier, Bankruptcy (14th ed. 1956), p. 1994, fn. 3.

masters, "the trustee and other officers" and their attorneys, the attorney for the debtor, the attorney for the petitioning creditors, indenture trustees, depositaries, reorganization managers, committees or representatives of creditors or stockholders, and certain other categories. Section 247 provides that "The judge shall fix a time of hearing for the consideration of applications for allowances," notice of which shall be given to a wide variety of parties in interest. After an intervening section not here relevant, comes § 249, quoted above.

If the words in the final sentence of § 249 "or other person acting in t' e proceedings in a representative or fiduciary capacity" were to be read in isolation and out of context, appellees would doubtless be right that Weinstein and Fried fell within them. However, as said in *United States* v. *American Trucking Ass'ns, Inc.*, 310 U. S. 534, 542 (1940), "To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the draftsmen of a statute." The last sentence of § 249 must be read not only with the preceding one but with the other sections of Article XIII. When the sentence is so read, it becomes fairly plain that the words "or other person acting in the proceedings in a representative or fiduciary capacity" relate only to persons so acting who fall within the categories allowed compensation under §§ 241, 242 or 243.

Officers of a debtor in possession are not among these. They are not "other officers" within § 241(3), at least if that term has the meaning specified in § 1(22), and we see no reason why it should not, since the defined meaning is not "inconsistent with the context." Nowhere do §§ 241, 242 and 243 refer to officers or employees of the debtor, an omission doubly significant in view of the specific mention of the attorney for the debtor in § 241(4). The reason for the

omission is plain enough. Such persons were not required to "seek compensation" through the necessarily cumbersome procedure of § 247, since compensation of officers of the debtor would have been approved under § 191 and employees would have been paid, under § 189, as if the debtor had remained solvent. Not being required to seek compensation under § 247, they have not been subjected to § 249, and the order of removal cannot survive the fall of its underpinning.[5]

Such a construction accords with the sense of the statute. The persons to whom Article XIII authorizes the allowance of compensation for services from the estate of the debtor are persons who would not have been rendering such services if the reorganization proceeding had not occurred. For these strangers the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from consensual arrangements, subject only, in the case of officers, to judicial approval under § 191. It would be altogether natural for Congress to prescribe that persons of the former sort, when acting in a representative or fiduciary capacity, should abstain from dealing in claims against or stock of the debtor on pain of forfeiting any right to compensation, without imposing a similar Draconian penalty upon the latter, who were being compensated during the Chapter X proceeding for the same executive services they had rendered before. At the very least, courts are justified in demanding a clear indication of Congressional purpose before inflicting what we have recognized as so harsh a forfeiture. *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, 868 (2 Cir. 1959), cert. denied, 361 U. S. 862 (1959), upon persons who, despite their fiduciary obligations, had been free to buy or sell stock of the corporation before

[5] Reversal of the order of removal carries with it so much of the order as authorized Philip to supervise the debtor's affairs pending approval of a general manager to replace Fried

the Chapter X proceeding was contemplated, *SEC* v. *Chenery Corp.*, 318 U. S. 80, 88 (1943); *Manufacturers Trust Co.* v. *Becker*, 338 U. S. 304, 312-314 (1949), and would expect to remain with it thereafter.

If it be contended against this that the president and the general manager of a debtor in possession bear essentially the same relation to creditors and stockholders and have the same access to inside information as a trustee, and that since § 249 applies to the latter, it must therefore apply to the former, there are several answers—apart from the sufficient one that this is not what the words say. One is that in a closely related respect Chapter X clearly distinguishes between what is demanded of a trustee and what is expected of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee whom the judge may appoint "to operate the business and manage the property of the debtor") must be "disinterested," which, under § 158(1), he is not if "he is a creditor or stockholder of the debtor." No such requirement was or practically could be imposed on officers of the debtor; instead, for that very reason, § 168 authorizes the judge to "appoint a disinterested person as examiner to prepare and file a plan" and to perform the investigative duties imposed upon the trustee by § 167(1) to (5). Also the argument under consideration proves too much. A salaried employee of the trustee entrusted with general supervision of the debtor's affairs, whether or not an officer of the debtor employed under § 191, would have the same access to inside information as the president or general manager of a debtor in possession; yet one would have to press hard, indeed, to read § 249 as including him.

Our ruling that § 249 is inapplicable to an officer or supervisory employee of a debtor in possession in no way entails as a consequence that a bankruptcy court is helpless to deal with breaches of fiduciary obligation on his

part. This Court has held, in the case of a person clearly within § 249, that failure to establish the purchase or sale that would trigger that section's denial of all compensation does not preclude or, indeed, relieve the court from taking account of related breaches of fiduciary obligation in fixing the amount, *Berner* v. *Equitable Office Building Corp.*, 175 F. 2d 218 (2 Cir. 1949). By the same token the court may consider, in an appropriate case, that a purchase or sale of stock by a person not within § 249 requires reduction or even elimination of compensation from an estate under the court's supervision, or removal of such person from office. See *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138, 146-147 (1940); see also *In re Midland United Company*, 159 F. 2d 340 (3 Cir. 1947). The distinction is that such a ruling would rest upon an exercise of judicial discretion, taking appropriate account of all relevant circumstances, rather than on the automatic forfeiture which the judge here thought the statute required. Nor is this all. Despite a statement to the House Judiciary Committee that § 249 was being presented in lieu of a proposal "that if a person in a fiduciary capacity uses inside information to purchase or sell securities, then he shall be penalized," [6] we cannot believe enactment of § 249 curtailed the inherent power of bankruptcy courts to impose remedies of a totally different sort for breach of fiduciary obligations, such as scaling down claims to the amounts paid or requiring an accounting for profits, even for persons subject to § 249 and surely for persons who are not; and again whether the final clause of § 212 is or is not literally applicable.[7] Decisions under § 77B providing

[6] *Supra* note 3.

[7] Section 212 permits the court, in the case of "an agent, attorney, indenture trustee, or committee," to "limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

for such a scale-down as against directors of a debtor in reorganization, *In re McCrory Stores Corp.*, 12 F. Supp. 267, 269 (S. D. N. Y. 1935), and *In re Philadelphia & Western Ry.*, 64 F. Supp. 738 (E. D. Pa. 1946), were noted with apparent approval in *Manufacturers Trust Co.* v. *Becker*, *supra*, at 314 fn. (1949); see also *In re Norcor Mfg. Co.*, 109 F. 2d 407, 411 (7 Cir. 1940) and *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77 (S. D. Cal. 1941). Cf. *Mosser* v. *Darrow*, 341 U. S. 267 (1951). Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees complain; indeed, the judge's denial of "recoupment" would indicate he did not regard their conduct as having been very iniquitous.

Appellants attack also the portions of the order approving Philip's election as a director and as treasurer and requiring his countersignature of checks; they assert that Philip's true allegiance is to Rehrig, who, they claim, is seeking to make a lease unfavorable to the debtor's interests.

The volume and character of the papers in this proceeding leave little doubt that directors' meetings attended by Weinstein and Philip are scarcely likely to set new records in pastoral harmony. However, Pennsylvania, where the debtor is incorporated, considers a minority's right to representation on a corporate board of directors so vital that it has enshrined cumulative voting in its Constitution, Art. XVI, § 3—although both proponents and opponents of that system recognize that the presence of sharply conflicting interests among the directors may result. See Williams, Cumulative Voting for Directors (1951), c. X; Baker and Cary, Cases and Materials on Corporations (3d ed, unabridged 1959), pp. 209-210; Young, The Case for Cumulative Voting, 1950 Wis. L. Rev. 49, 53; Axley, The Case Against Cumulative Voting, 1950 Wis. L. Rev. 278, 279. Consistent and vigor-

ous advocacy of policies honestly deemed by the majority to be seriously adverse to corporate interests would thus not be a ground for disqualifying a minority director in Pennsylvania, although a record of actual obstruction would be, *Markovitz v. Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939). To be sure, a court of bankruptcy is not bound to approve a director simply because he has been elected to represent a minority through cumulative voting, any more than it would be to approve one elected by a majority with or without such procedures. Still some weight ought to be given to Pennsylvania's policy and, even apart from that, the stockholders' election of directors "will not be disturbed unless a clear case of abuse is made out" or it appears that judicial veto is required "to the end that the property may be safely and effectively managed." *In re J. P. Linahan, Inc.*, 111 F. 2d 590, 592 (2 Cir. 1940). As one of three directors Philip will have no power to force the making of a lease to Rehrig, and this presumably would require the court's approval in any event. There is nothing as yet to show that as a director, or as treasurer, Philip will obstruct the operation of the business in the private interest of the Rehrig group as distinguished from acting as its voice and ears; we read § 188 as empowering the court to remove him if he should. On the other hand, the requirement of Philip's countersignature of all checks might well jeopardize the successful functioning of the business; indeed, it is not at all clear that the judge meant this to continue beyond the appointment of a new general manager in place of Fried.

The order is therefore reversed save for its approval of the election of directors and officers, as to which it is affirmed.[8]

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[8] Nothing herein is to be deemed to preclude the judge from taking any further action with respect to directors or officers that he may find appropriate as a result of our decision in Docket Nos. 27000 and 26962.

# Appendix C

## Text of Statutes Cited

**Bankruptcy Act, §§ 1(22), 1(23): 11 U.S.C. §§ 1(22), 1(23); 52 Stat. 840 (1938):**

§ 1. *Meaning of Words and Phrases*

The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * * .

(22) "Officer" shall include clerk, marshal, receiver, custodian, referee, and trustee, and the imposing of a duty upon, or the forbidding of an act by, any officer shall include his successor and any person authorized by law to perform the duties of such officer;

(23) "Persons" shall include corporations, except where otherwise specified, and officers, partnerships, and women, and when used with reference to the commission of acts which are forbidden under this Act shall include persons who are participants in the forbidden acts, and the agents, officers, and members of the board of directors or trustees or of other similar controlling bodies of corporations; * * *.

**Bankruptcy Act, § 115; 11 U.S.C. § 515; 52 Stat. 884 (1938):**

§ 115. *Same; Jurisdiction as in Insolvency*

Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.

## *Appendix C*

**Bankruptcy Act, § 116(1); 11 U.S.C. § 516(1); 52 Stat. 885 (1938):**

§ 116. *Same; Additional Jurisdiction over Administration of Estate*

Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate; * * *.

**Bankruptcy Act, § 156; 11 U.S.C. § 556; 52 Stat. 888 (1938):**

§ 156. *Appointment of Trustees; Continuance of Debtor in Possession*

Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

*Appendix C*

**Bankruptcy Act, § 157; 11 U.S.C. § 557; 52 Stat. 888 (1938):**

§ 157. *Attorney for Trustee*

An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: *Provided, however,* That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

**Bankruptcy Act, § 158; 11 U.S.C. § 558; 52 Stat. 888 (1938):**

§ 158. *Interest of Persons*

A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—

(1) he is a creditor or stockholder of the debtor; or

(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

## *Appendix C*

**Bankruptcy Act, § 168; 11 U.S.C. §568; 52 Stat. 890 (1938):**

§ 168. *Same; Disinterested Person Where Debtor is in Possession*

If a debtor is continued in possession, the judge may at any time appoint a disinterested person as examiner to prepare and file a plan and to perform the duties imposed upon a trustee under paragraphs (1) to (5), inclusive, of section 167 of this Act, or to perform any of such duties.

**Bankruptcy Act, § 188; 11 U.S.C. § 588; 52 Stat. 892 (1938):**

§ 188 *Debtor in possession; title, rights, duties, and powers*

A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe.

**Bankruptcy Act, § 191; 11 U.S.C. § 591; 52 Stat. 893 (1938):**

§ 191. *Employment of Officers of Debtor*

A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court.

**Bankruptcy Act, § 196; 11 U.S.C. § 596; 52 Stat. 893 (1938):**

§ 196. *Filing and Allowing Proofs of Claims; Objections to Allowances*

After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the

proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the Court.

**Bankruptcy Act, § 212; 11 U.S.C. § 612; 52 Stat. 895 (1938):**

§ 212. *Same; Regulation by Court*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation of in the course of the proceeding under this chapter to the actual consideration paid therefor.

**Bankruptcy Act, § 221(4); 11 U.S.C. § 621(4); 52 Stat. 897 (1938):**

§ 221. *Confirmation by Court*

The judge shall confirm a plan if satisfied that— * * *

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; * * *.

## *Appendix C*

**Bankruptcy Act, § 247; 11 U.S.C. § 647; 52 Stat. 901 (1938):**

§ 247. *Hearing of applications*

The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, except that, in the case of allowances for services and reimbursement in a superseded bankruptcy proceeding, notice need be given only to the applicants, the debtor, the trustee, and the unsecured creditors, and may be given to such other classes of creditors or other persons as the judge may designate. In the case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that bankruptcy be proceeded with, notice of the hearing to consider allowances need not be given to stockholders.

**Bankruptcy Act, § 249; 11 U.S.C. § 649; 52 Stat. 901 (1938):**

§ 249. *Statement of Claims or Stock Acquired or Transferred after Commencement of Proceeding*

Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

*Appendix C*

**Amendatory Act, § 5b; Additional Provisions of the Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840), § 5b; 11 U.S.C. § 1, notes:**

§ 5. *Severability; Headings.*

* * *

b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate.

**Bankruptcy Act, § 77B(c); 11 U.S.C. § 207(c); 48 Stat. 915 (1934) [*Repealed*]:**

§ 77B(c) [*Repealed*] Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction and powers elsewhere in this section conferred upon him, * * *

(9) may allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the proceeding and the plan by officers, parties in interest, depositaries, reorganization managers and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing and of the debtor, but appeals from orders fixing such allowances may be taken to the Circuit Court of Appeals independently of other appeals in the proceeding and shall be heard summarily; * * *

While the debtor is in possession (a) its officers shall be entitled to receive only such reasonable compensation as the judge shall from time to time approve, and (b) no person shall be elected or appointed to any office, to fill a vacancy or otherwise, without the prior approval of the judge.

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**Bankruptcy Act, § 77B(f)(5); 11 U.S.C. § 207(f)(5); 48 Stat. 919 (1934) [*Repealed*]:**

§ 77B(f) [*Repealed*] After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that * * *

(5) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, and all amounts to be paid to committees or reorganization managers, whether or not by the debtor or any such corporation for services or expenses incident to the reorganization, have been fully disclosed and are reasonable, or are to be subject to the approval of the judge; * * *.

**28 U.S.C. § 1652; 62 Stat. 944 (1948):**

§ 1652. *State laws as rules of decision*

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

**Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U.S.C. § 2072:**

Rule 52. *Findings by the Court*

(a) EFFECT. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes

of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

**Pa. Constitution, Art. XVI, § 7 (1874, 1956):**

§ 7. *Stocks and bonds; increase of indebtedness*

No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of general law, *nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting to be held after sixty days notice in pursuance of law.* [*Italicized words deleted by 1956 amendment.*]

**Pa. Bus. Corp. L. § 604; 15 Purdon's Pa. Stats. Ann. § 2852-604; P.L. 364, Art. VI, § 604 (1933):**

§ 604. *Payment of Subscriptions for Shares*

Unless otherwise provided in the subscription agreement, subscriptions for shares, whether made before or after the organization of a corporation, shall be paid in full at such time, or in such installments and at such times, as shall be determined by the board of directors. Any call made by the board of directors for payment of subscriptions shall be uniform as to all shares of the same class, or as to all shares of

the same series, as the case may be. The director shall cause notice of the amount of any call, and of the time and place of payment, to be given at least thirty days before the date the call is due, either personally or by mail addressed to each shareholder at his last address, as it appears on the books of the corporation. If a shareholder be indebted to a business corporation on account of unpaid subscriptions for shares, the corporation shall have a lien upon such shares for such indebtedness. Shares for which the agreed consideration has been paid, delivered, or rendered to the corporation shall be fully paid shares and non-assessable. No note or obligation given by a shareholder, whether secured by pledge or otherwise, shall be considered as payment, in whole or in part, of any shares of a business corporation.

**Pa. Bus. Corp. L. § 605; 15 Purdon's Pa. Stats. Ann. § 2852-605; P.L. 364, Art. VI, § 605 (1933):**

**§ 605.** ***Defaults in Payment of Consideration for Shares***

When any shareholder fails to pay any call upon his shares properly made by the directors, at the time when such payment is due, the directors may proceed to collect the amount due in the same manner as any debt due the corporation, or they may sell, at public sale, such part of the shares of the delinquent shareholder as will pay all or any part of the installments then due from him, with interest and all incidental expenses, and transfer the shares so sold to the purchaser, who shall be entitled to a certificate therefor. Notice of the time and place of such sale, and of the sum due on each share, shall be given by advertisement, once a week for two consecutive weeks next preceding the date fixed for the sale, in a newspaper of general circulation published in the county where the corporation has its registered office and in the legal newspaper, if any, designated by the rules of court for the publication of legal

notices in such county, or, if there be no newspaper of general circulation published in such county, then in a newspaper of general circulation in such county, and such notice shall be mailed by the treasurer of the corporation to the delinquent shareholder, at his last known post office address, at least twenty days before the date fixed for such sale. If no bidder can be had to pay the amount due on the shares, or if the amount is not collected by an action at law brought within the county where such corporation has its registered office, the shares shall be forfeited to the corporation, and the amount previously paid in by the delinquent shareholder on the shares shall be forfeited to the corporation. Such shares, if forfeited, may be reissued or reoffered for subscription by the corporation. No share shall be voted at any meeting upon which any installment is due and unpaid.

**Pa. Bus. Corp. L. § 609; 15 Purdon's Pa. Stats. Ann. § 2852-609; P.L. 364, Art. VI, § 609 (1933):**

§ 609. *Liability of Subscribers and Shareholders*

A subscriber to, or holder of, shares of a corporation formed under this act shall not be under any liability to the corporation with respect to such shares, other than the obligation of complying with the terms of the subscription for such shares. Any person becoming an assignee or transferee of shares, or of a subscription for shares, in good faith and without knowledge or notice that the full consideration therefor has not been paid, shall not be personally liable to the corporation or its creditors for any unpaid portion of such consideration. No person holding shares as executor, administrator, guardian, trustee, receiver, or in any other representative or fiduciary capacity, shall be personally liable as a shareholder by reason of so holding such shares, but the estate and funds in the hands of such fiduciary or representative shall be so liable. No pledgee or

other holder of shares as collateral security shall be personally liable as a shareholder, but the person pledging such shares shall be considered the holder thereof and shall be liable as a shareholder.

**Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P.L. 364, Art. VI, § 610 (1933):**

§ 610. *Validity of Shares*

The fact that shares are issued in violation of, or without full compliance with, the provisions of this act shall not make the shares so issued invalid, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth.

**15 Purdon's Pa. Stats. Ann. § 315; P.L. 126, § 15 (1911) [*Repealed*]:**

§ 315. *Lien of corporation and restrictions on transfer*

There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation, and there shall be no restriction upon the transfer of shares so represented, by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

**12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-103; P.L. 3, § 8-103 (1953):**

§ 8-103. *Issuer's Lien*

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is set forth conspicuously on the security.

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**12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-204; P.L. 3, § 8-204 (1953):**

§ 8-204. *Effect of Issuer's Restrictions on Transfer*

A restriction on transfer imposed by the issuer even though otherwise lawful is ineffective unless noted conspicuously on the security.

**21 Purdon's Pa. Stats. Ann. § 601, P.L. 425, § 1(1901):**

§ 601. [*RESULTING TRUSTS*] *Validity*

Whenever hereafter a resulting trust shall arise with respect to real property, by reason of the payment of the purchase money by one person, and the taking or making of a legal title in the name of another, if the person advancing the purchase money has the capacity to contract, such resulting trusts shall be void and of none effect as to bona fide judgment or other creditors, or mortgagees of the holder of the legal title, or purchasers from such holder without notice unless either (1) a declaration of trust in writing has been executed and acknowledged by the holder of the legal title, and recorded in the recorder's office of the county where the land is situated, or (2) unless an action of ejectment has been begun, in the proper county, by the person advancing the money, against the holder of the legal title.

**N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 91:**

§ 91. *Certain uses and trusts abolished*

Uses and trusts concerning real property, except as authorized and modified by this article, have been abolished; every estate or interest in real property is deemed a legal right, cognizable as such in the courts, except as otherwise prescribed in this chapter.

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**N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 94:**

§ 94. *Grant to one where consideration paid by another*

A grant of real property for a valuable consideration, to one person, the consideration being paid by another, is presumed fraudulent as against the creditors, at that time, of the person paying the consideration, and, unless a fraudulent intent is disproved, a trust results in favor of such creditors, to an extent necessary to satisfy their just demands; but the title vests in the grantee, and no use or trust results from the payment to the person paying the consideration, or in his favor, unless the grantee either,

1. Takes the same as an absolute conveyance, in his own name, without the consent or knowledge of the person paying the consideration; or,

2. In violation of some trust, purchases the property so conveyed with money or property belonging to another.